

**THE IMPACT OF THE REVISION OF
THE LARGE-SCALE RETAIL STORES LAW
ON THE JAPANESE DISTRIBUTION SYSTEM**

Thesis
presented to the Faculty of Arts
of
the University of Zurich
for the degree of Doctor of Philosophy

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Accepted in the fall semester 2010 on the recommendation of
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Zurich, 2010

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1 Introduction

The subject of Japan's economy became a matter of burgeoning interest to the world during the 1970s and 1980s for two reasons. Firstly, Japan's economic success loomed increasingly larger on the international stage, with Japanese goods showing up everywhere. Secondly, the trade surpluses Japan enjoyed with a number of countries, and especially the bilateral trade imbalance between the United States and Japan, became a potent political topic (see Mosk, 2008: 351ff). Political friction over Japan's continuing trade surpluses became an "ongoing drone, a rhythmic drumbeat" for American diplomacy in terms of its relationship with Japan (Mosk, 2008: 325). However, it was not the trade imbalance that was the crux of the matter but the perceived lack of reciprocity at play: that Japan's economic success was due in some degree to anticompetitive practices that protected Japan's domestic market and granted an unfair advantage to Japanese companies as they expanded abroad (see Kotabe and Weiler, 1996: viii).

In 1989, the United States initiated broad talks concerning Japan's anticompetitive practices and structural factors inhibiting manufactured imports into Japan during the Structural Impediments Initiative (SII) talks. These talks addressed such areas as the law restraining the growth of large retail stores in Japan, weak antitrust law enforcement, land taxation that encouraged inefficient farming, and high real estate prices. The talks also addressed Japan's distribution system, which was identified as a key factor in shielding existing participants in the Japanese market from newcomers, especially their foreign counterparts (see Maguire, 2001). According to United States representatives, the Japanese distribution system with its large number of small retailers, long and complex distribution channels, distribution *keiretsu*¹ and specific trade practices, inhibited competition, denied Japanese consumers the full benefits of a

¹ Ishida (1983: 322) defines a vertical *keiretsu* in distribution as: "Systematic or interrelated efforts by manufacturers (and wholesalers) to force retail dealers to organize in order to promote cooperation as well as to force them to carry out producer-determined policies at the retail level."

free and strong economy, and limited product availability as well as American businesses' opportunity to sell competitive products (see Verity, 1988).

The final report of the Structural Impediments Initiative listed five consensual measures for Japan to use to improve its distribution system and to make its market more accessible to its foreign counterparts. These measures included the break-up of vertical *keiretsu* in distribution, the speeding up of import clearance procedures (see Mosk, 2008: 327)², and the revision of the law restraining the growth of large retail stores, the Large-Scale Retail Stores Law (*daitenhō*).³ The expectations of the government, business and academic community both inside and outside Japan grew based on the developments that the revised statute had promised, and an imminent revolution in the Japanese distribution system was anticipated (see for example Goldman, 1991: 171-172). The number of large retailers would increase, small retailers would be driven out of business, wholesale channels would shorten, and direct sourcing between retailers and manufacturers would increase; in other words, Japan's distribution system would finally be modernized.

1.1 Literature review

There is a limited number of Japanese and non-Japanese studies on the effect of the revision of the Large-Scale Retail Stores Law on the Japanese distribution system. The majority of studies focus almost entirely on the effect of this law on the retail sector.

Lothia and Subramaniam (2000) discuss the changes in the Japanese retail structure between 1985 and 1994 and the expected changes after 1994. They examine structural characteristics such as the total number of retail establishments, the number of retail

² Japan demanded that the United States clarify its anti-dumping measures, end language-based discrimination in international patent agreements, and reform product liability law.

³ The Japanese term for the Large-Scale Retail Stores Law is *daikibo kouri tenpo ni okeru kourigyō no jigyō katsudō no chōsei ni kansuru hōritsu* (Law Concerning the Adjustment of Retail Business Activities of Large-Scale Retail Stores). It is abbreviated as *daitenhō*.

For more on the *daitenhō*, see chapter 3.

formats, catalog mail order sales, and computer mail order sales. These authors expected the Large-Scale Retail Stores Law to continue the increase in the number of large stores and the decrease in the number of small retail stores. Demographic trends fueled the increase of large stores. For instance, more women began working outside the house and thus took advantage of the convenience of one-stop shopping. Increased car ownership also had an impact.

Riethmuller and Chai (1999) examine the effect of the revised statute on foreign food exporters. They conclude that in theory, the removal of the Large-Scale Retail Store Law facilitates the efforts of large companies to open new stores. There are, however, no grounds for believing that the spoils of deregulation should go exclusively to new foreign players. The Japanese food processing industry is a large industry that has advantages over its foreign competitors. In addition, the cost and availability of land and the profitability of large supermarket operations relative to other investment alternatives may cause some firms to decide that not expanding is the best policy.

Davies and Itoh (2001) study the effect of the revised statute on retail structure in Japan. They conclude that the change in legislation could be associated with a change in the Japanese retail structure and thus with more large stores; however, the change has occurred more slowly than might have been expected.

There have also been studies of the issue published in Japanese, including that of Mineo (2008), who examined government regulation of large retail stores in Japan and found that the increase in the number of large stores (defined as stores with over 500 m²) accelerated after the revision of the Large-Scale Retail Stores Law. In an earlier study, Mineo (2004) examined the changes in retail structure with regard to sales floor space. She found that in 2002, 80% of all stores were still very small, with sales floor space between 30 m² and 50 m². In 1979, 92% of all stores were of this size. In contrast, only 0.3% of all stores were mega-stores with more than 3'000 m² sales floor space, though this figure was up from 0.1% in 1979. Except for the smallest stores, all stores also showed positive growth rates between 1979 and 2002.

Tamura (1992) studies the impact of the revised statute on the location of large retail stores with data for the period between June 1990 and February 1991. He analyzes the

number of applications for large stores submitted to the MITI (Ministry of Trade and Industry)⁴ and finds that, for planned large-store openings, there was a shift away from the three metropolises (Tokyo, Osaka, and Nagoya) to other regions in Japan and a shift away from the commercial centers of prefectures to the suburbs of those prefectures.

Nogata (1998) writes that the increase in the number of large stores can be attributed to the revised statute, though he finds that the decrease in the number of small stores was caused by a general decline in prices and more imported goods. He also discusses the effect of the revised statute on retail prices and concludes that there is not always a positive relationship between retail prices and the number of large stores.

We do not know of any studies examining the effects of the revised statute on the structure of the Japanese distribution system more broadly. This study is intended to fill this gap by not only analyzing the developments in the retail sector after the revision of the statute but also by examining the developments in the wholesale sector (that is, the number of wholesale establishment and wholesale circuitry⁵) and in direct sourcing. In addition, this study aims to contribute to the body of research on the impact of legislation on the retail sector, and, more broadly, on the distribution sector in general.

1.2 Research objective and research hypothesis

This study investigates the effects of the revision of the Large-Scale Retail Stores Law in 1991 and its enactment in 1992 on the Japanese distribution system. The objective of this study is to assess whether the anticipated developments, as roughly outlined in the introduction, actually took place in the years after the revision of the Large-Scale Retail Stores Law. Our research hypothesis is presented below.

If the Large-Scale Retail Stores Law has shaped the structure of the Japanese retail sector with respect to its large number of small retailers, then its revision should have

⁴ In 2001, MITI was reorganized and renamed the Ministry of Economy, Trade and Industry (METI).

⁵ Wholesale circuitry refers to the number of separate title-holding intermediaries between a manufacturer and a retailer or individual demander.

led to the following developments in the Japanese distribution system:

- **More large stores:** The number of large stores should have increased because regulatory constraints on size were relaxed.
- **Fewer small stores:** The number of small stores should have declined because they were faced with increased competition from large stores and the loss of regulatory protection.
- **Shorter distribution channels:** With the number of large retailers increasing, trade flows between manufacturers and retailers should have increasingly gone through one level of wholesalers only. Wholesale circuitry should have improved.⁶
- **More direct sourcing:** Direct sourcing between manufacturers and retailers should have increased due to large retailers' channel power.⁷ Large retailers, because of their size, should have been able to force manufacturers to supply them directly. In addition, large retailers should no longer have depended on wholesalers as order placing and processing nodes because of the implementation of inter-firm EDI (electronic data interchange) systems linking manufacturers and retailers, and POS (point of sales) systems enabling retailers to make the right sourcing decision based on their analysis of the sales-related information gathered by POS systems.
- **Fewer wholesale establishments:** The number of wholesale establishments should have declined as a result of the decline in the number of small retailers and because of shorter distribution channels and more direct sourcing.

The main period of interest spans the years 1992 (the year the revised statute was enacted) to 2000 (the year the revised statute was replaced with the Law Concerning Measures by Large-Scale Retail Stores for Preservation of the Living Environment). However, to obtain a broader perspective, we take into account data from all years

⁶ It is generally assumed that the number of separate title-holding intermediaries between a manufacturer and a retailer increases when the retailer is smaller. See also chapter 2.

⁷ In this study, channel power is understood as the ability or the potential of a particular channel member to control or influence the decision-making and behavior of one or several other channel member(s). See more on channel power in chapter 2.

available, namely 1960 to 2004.

1.3 Structure, main findings and limitations

1.3.1 Structure and main findings

We begin by presenting the theoretical background necessary for one to understand the discussion concerning the revision of the Large-Scale Retail Stores Law (chapter 2). This background includes a discussion of the external factors shaping retailer size, including legislation, and the factors influencing the ability of retailers to either internalize wholesale functions or shift them to manufacturers. Based on the findings in the secondary literature, we develop a conceptual framework that is helpful for our analysis. Chapter 2 also includes an overview of the salient features of Japan's postwar distribution system (1945-1990) and how other scholars explain them.

Chapter 3 focuses on the role of the distribution system and the Large-Scale Retail Stores Law in Japan's trade disputes with the United States. We review the history of the statute and introduce a number of developments, so-called associated changes, which have been assumed to further contribute to the changes in Japan's distribution system.

In chapter 4, we look for quantitative evidence to support our research hypothesis. We find that based on the statistics obtained for this study, the growth in the number of large retail establishments may be associated with the revision of the statute in question. However, the rate of change is found to be relatively small, and the causality between the revision of the statute and the change in the structure of the retail market is questioned.

In considering the decline in the number of small, traditional retailers, we find that the revised statute cannot be identified as the primary reason for the change. The decline had already begun between 1982 and 1985: that is, before the implementation of the revised statute.

Furthermore, we find that the number of wholesalers in all wholesaler categories except

one decreased after the implementation of the revised statute. However, there was a significant increase in the number of intermediate wholesalers that cannot be explained as a consequence of the implementation of the revised statute.

With regards to wholesale circuitry, we find that the ratios frequently used to assess the length of the distribution channels are not adequate to determine the internal structure of the wholesale sector.

Due to a lack of data, we are unable to quantitatively confirm that developments in direct sourcing were related to the application of the statute in question.

In chapter 5, we discuss those data analysis results that question or do not support our research hypothesis. These include the following results:

- (1) The slow rate of change in the number of large retail stores.
- (2) The initiation of a decrease in the number of small retailers prior to the implementation of the revised statute during the years 1982 – 1985.
- (3) The increase in intermediate wholesalers during the years studied.
- (4) Developments with respect to direct sourcing.

The details of these four results are as follows:

Result (1): We analyze the revised statute and associated changes in more detail and find that there are still a number of factors that limit the expansion of large stores.

Result (2): We find that the decline in the number of small traditional retailers was caused by certain retail formats' establishing competitive advantage over traditional small-scale retailers that traditionally had enjoyed the advantage.

Result (3): We find that the end of Japan's bubble economy led several businesses to assess their business profiles, which in turn led to an increase in intermediate wholesalers.

Result (4): We conclude based on our qualitative analysis that direct sourcing did not significantly increase after the implementation of the revised statute.

With these findings in mind, we suggest that the optimistic evaluations of the improved

ability of the Japanese distribution system to cater to the needs of large-scale retail establishments have been based on a number of misconceptions regarding the Japanese distribution system.

1.3.2 Limitations

The focus of this study is the Japanese distribution system for consumer goods sold to consumers through physical outlets. The study aims to analyze the impact of the revised statute on independent distribution channels including legally independent entities such as wholesalers and retailers. The impact of the revised statute on the number of agents or brokers is not studied. In addition, the impact of the revised statute on distribution *keiretsu*, intra-company distribution channels, mail order channels, and e-commerce channels is not a focus of this study.

2 Theoretical background

Chapter 2.1 gives the reader the necessary theoretical background to understand the discussion concerning the revision of the Large-Scale Retail Stores Law. The revision of the statute was expected to lead to an increase in the number of large retailers, which would force small retailers out of business, thereby causing the number of small retailers to decline, shorten distribution routes and initiate more direct sourcing.

With regard to our research hypothesis, we focus on two questions. First, what (external) factors affect retailer size? Secondly, what factors influence the ability of retailers to alter sourcing routes (for example, by initiating direct sourcing)? Based on the evidence in the secondary literature, we then develop a framework that is useful for assessing these two questions, which are central to our research hypothesis.

To apply the findings from chapter 2.1 to the Japanese context, we introduce Japan's postwar distribution system and its salient features in chapter 2.2. This section is followed by an overview of the various explanations and theories proposed regarding these features.

2.1 Determinants of retailer size and wholesaler channels

The term “distribution system” refers to a system of interdependent organizations that carry out marketing activities to create and deliver value in the form of products and services to intermediate and ultimate customers or clients. For Stern and Reve (1980: 55), the primary function of a distribution system in a society is to bridge the gap between production and consumption.

Distribution systems are also referred to as marketing channels, distribution channels, business channels, and value chains.

The participants in almost any distribution system can be classified as follows:

- Retailers – These are individuals (or groups) who ultimately sell a product or service to end users or customers. They can be grouped according to ownership type (i.e., independent, franchise or chain store ownership), pricing philosophy (i.e.,

discounts versus full-price offerings), product assortment (i.e., breadth and depth of product lines), and service level.

- Wholesalers – These are intermediaries or middlemen who buy products from manufacturers and sell them to retailers. They take the same type of financial risk as retailers because they purchase the products, keep them in inventory until they are resold to retailers, and may arrange for shipment to those retailers.
- Agents and/or brokers – These are intermediaries who connect suppliers to retailers. They do not take ownership of the products that they sell, and they are independent sales representatives who typically work on commission, with commissions based on sales volumes. They may sell to both wholesalers and retailers.

Manufacturers can choose between various distribution arrangements to reach the end consumer. Retailers also have the option to source directly from the manufacturer or through wholesalers. The various types of distribution system structures can be distinguished from one another based on how participants are involved in the distribution channel:

- Direct channel: The same company that manufactures a product sells it directly to the consumer or end user.
- Retailer channel: The producer sells directly to retailers, who then sell the products to consumers.
- Wholesaler channel: Manufacturers sell to wholesalers, who might sell either to other wholesalers or directly to retailers, who then sell to consumers.
- Agent or broker channel: This type of arrangement can include producers selling to agents or agents selling to wholesalers, who sell to retailers, who then sell to consumers.

Why and when do manufacturers and retailers include wholesalers in their distribution arrangement? According to marketing theory, manufacturers and/or retailers will include wholesalers in their distribution arrangement if the latter perform certain functions with higher levels of efficiency and/or effectiveness. Functions that wholesalers can perform for manufacturers include the following (see Stern, El-Ansary,

and Coughlan, 1996: 116-117).

- **Market coverage:** If customers are spread over large geographic areas, manufacturers can achieve good market coverage and ensure the ready availability of products when needed at reasonable cost by relying on wholesalers instead of building up their own outside sales force.
- **Sales contact:** If a manufacturer's products are sold to a large number of customers spread over a large geographic area, manufacturers may be able to significantly reduce the cost of outside sales contacts by using wholesalers to cover all or a substantial portion of their customers. Manufacturer sales forces would then only need to call on a relatively small number of wholesalers rather than on a much larger number of customers.
- **Inventory holding:** Manufacturers can reduce both their financial burden and the risk associated with holding large inventories by using wholesalers that take title to and stock the products by the manufacturers that they represent. Moreover, wholesalers can help manufacturers to better plan their production schedules by providing an available outlet for manufacturer products.
- **Order processing:** Many customers buy in very small quantities regardless of the size specified by the manufacturer. Processing a large number of small orders can be too costly for manufacturers. When wholesalers carry products by many different manufacturers, the order-processing costs for wholesalers can be absorbed via the sale of a broader array of products than would be available from a single typical manufacturer.
- **Market information:** Wholesalers are in a good position to learn about customer product and service requirements because they are often geographically quite close to their customers and because they often have regular contact with their customers through frequent sales calls. If the information that they thereby cull from their customer relationships is passed on to manufacturers, it can prove valuable for product planning, pricing, and developing competitive marketing strategies.
- **Customer support:** In addition to buying products, customers may require many

kinds of service support (e.g., product exchange or return, set-up and adjustment, repairs, and technical assistance). For manufacturers to provide all of these services directly to large numbers of accounts can be very costly and ineffective. The alternative is for wholesalers to assist manufacturers in providing these services to customers.

Manufacturers are not the only players who can potentially benefit from wholesaler actions. Retailers can also benefit from including wholesalers in their sourcing arrangements.

- **Product availability:** Wholesalers are usually close (or closer than manufacturers) to retailers and sensitive to their needs. They can provide retailers with a level of product availability that would be hard for many manufacturers to match.
- **Assortment convenience:** Wholesalers can bring together an assortment of products from a variety of manufacturers and thereby greatly simplify a retailer's ordering tasks. Instead of having to order from a large number of manufacturers, retailers can limit their orders to a few general lines of specialty wholesalers that can provide them with the products they need.
- **Bulk breaking:** Retailers most often do not need large quantities of particular products as part of a given order. Manufacturers, however, find it costly to sell directly to small-order customers; often they discourage small orders by establishing minimum order requirements. Wholesalers provide retailers with the ability to buy only in the quantities they need by purchasing large quantities from manufacturers and breaking these bulk orders into smaller quantities as required by the retailers.
- **Credit and finance:** Wholesalers can assist retailers financially in two ways. First, they can extend open account credit on products sold. Second, they can stock and provide readily available products, thereby greatly reducing the financial inventory burden on their customers. Wholesalers sometimes also extend long-term credit, as in the toy industry (see Stern, El-Ansary and Coughlan, 1996: 119).
- **Customer service:** Wholesalers can save their retailers considerable effort and

expense by providing services such as delivery, repairs, and warranties to end-consumers.

- **Advice and technical service:** Wholesalers can support their customers by providing proper product use assistance to end-consumers through trained outside sales forces (see Stern, El-Ansary and Coughlan, 1996: 117-118).
- **Merchandise management:** High-performance wholesalers are very knowledgeable about retail merchandise management. Because they know precisely what to buy, they can minimize handling and inventory costs.
- **Sales activities:** Wholesalers can support the sales activities of their retail customers by granting price concessions on featured items, providing POS promotional material, and designing cooperative advertising. Sometimes, unsold merchandise can be returned to wholesalers for full credit.
- **Store design:** Wholesalers can support retailers in establishing store layout, building design, and material specifications.
- **Management functions:** Wholesalers can offer retailers guidance regarding public relations, housekeeping and accounting methods, information systems, and administrative procedures.
- **Storage function:** Reliance on wholesalers allows the conversion of storage space devoted to merchandise storage into profit-making sales or customer service space.
- **Access to a large number of manufacturers:** Wholesalers can provide retailers with access to a large group of products from small manufacturers that might not otherwise be accessible to them. If large retailers were to decide to source such products directly, they might lose access to a wide range of small manufacturers because of retaliations from wholesalers.

Stern and Reve (1980) note that the distribution of functions within a distribution channel among channel participants is the outcome of a process referred to as a channel internal economic process or decision mechanism. Agreement on the division of channel functions among members can be reached in impersonal, routine or habitual ways, via bargaining, or via centralized planning processes. Channel power, defined as

the potential to influence, is considered to play a central role in the decision-making process (see Frazier, 1999). In this study, channel power is understood as the ability or potential of a particular channel member to control or influence the decision-making and behavior of one or several other channel member(s).⁸

While wholesalers can be eliminated within a channel, the functions that they perform cannot be eliminated but must instead be shifted either forward or backward in the channel and assumed by other members (Stern, El-Ansary and Coughlan 1996: 8). Such a shifting of function(s) leads to an increase in costs and requires the channel participant(s) assuming the functions to have the necessary resources (financial resources, know-how, and personnel). The increase in cost is justifiable to the extent that it may be necessary to provide the right quantity goods to customers at the right time and in the right place.

The implications for our research hypothesis are as follows. When retailers internalize wholesaler functions, they need to have the necessary resources to efficiently and effectively perform those functions. When retailers want to shift wholesaler functions to manufacturers and make them bear the additional costs, they need to have the necessary power to do so.

Retailer size (in terms of sales floor space) is viewed as an important factor in influencing both resources and power. The smaller the retailers, the more likely they are to include wholesalers in their sourcing arrangement because they probably lack the resources necessary to internalize wholesaler functions and the power to shift wholesaler functions to manufacturers (see, for example, Ito and Maruyama, 1990). Large retailers, on the other hand, may have the necessary resources and are viewed as having the necessary power by virtue of their size (see Galbraith, 1952) because they can threaten to deny manufacturers access to retailers' markets (see Etgar, 1976). Retailer power can also stem, for example, from a favorable image or information advantage.

⁸ See more on channel power in chapter 2.2.

To summarize, retailers, to be able to internalize wholesaler functions, need to have the necessary *resources*. Furthermore, to be able to shift wholesaler functions to manufacturers, they need to have *power* to do so. Power and resources are assumed to increase with *size*. Resources, however, cannot only be the result of size but are also considered a prerequisite for it. Both resources and power affect wholesale circuitry, defined as the number of separate title-holding intermediaries between a manufacturer and a retailer. It is assumed that the more resources and power retailers possess, the more wholesaler functions are either internalized or shifted to manufacturers by retailers and the smaller wholesale circuitry is. In the case of direct business transactions between the manufacturer and retailers, wholesale circuitry is zero.

One important factor shaping retailer size is, as our research hypothesis suggests, *legislation* (in the Japanese case, the Large-Scale Retail Stores Law). The impact of legislation on retailer size and retail structure⁹ in various countries is well documented (e.g., Leunis and Francois, 1988; Hollander and Ohmura, 1989; Davies and Harris, 1990; Treadgold and Sanghavi, 1990; Davies and Itoh, 2001). Such legislation is usually intended to restrict large-scale retailing businesses. Planning legislation restricts the ability of retailers to build larger outlets, while pricing legislation affects the ability of large retailers to use their purchasing power to gain competitive advantage by offering lower prices. In the United States, the Robinson-Patman Act prohibits sales that use price to discriminate between the sales of goods to different, equally situated distributors when the effect of such sales is to reduce competition. The act grew out of practices in which chain stores were allowed to purchase goods at lower prices than other retailers. Laws such as the *Loi Royer* in France, the *Loi Cadenas* in Belgium, and Germany's *Baunutzungsverordnung* limit retail development to a certain size. In The Netherlands, the number of stores in each area is limited by population size (see Lyle, 1995). Both planning and pricing legislation restrict the power of large-scale retailers to

⁹ We define this as the ratio of the total number of fixed shops to that of the population. Such a measure reflects retail concentration (often the market share of the top 5 or top 10 retailers) and store size, the two targets of the revised statute.

use any economies of scale or scope¹⁰ that can be derived from the nature of their operations (see Davies and Itoh, 2001: 83).

In a market unrestricted by any regulations (or in one that is only limitedly or vaguely regulated), the number of small-scale retail businesses is expected to fall over time because larger retail stores are more economical and cost-efficient to operate due to economies of scale. Furthermore, because small-scale retailers tend to purchase via wholesalers more often than their larger rivals (which, in an unconstrained market, can negotiate preferential discounts in direct negotiation with suppliers), legislation directed toward the retail sector can have an indirect, unintentional impact on the wholesale sector as well (see Davies and Itoh, 2001: 84-85). The greater the number of large retailers, the less dependent the retail sector becomes on the wholesale sector and the greater the power of retailers within the distribution channel.

The concept of power is a major research area not only in research on distribution systems, but also in the study of organizations and the interactions of organization members in general. Gaski (1984) defines power simply as the ability to get someone to do something he/she would not have done otherwise.

Distribution channel power theory was developed in the 1960s based on the behavioral sciences (see, for example, Beier and Stern, 1969; Hunt and Nevin, 1974). This field experienced a revival with the development of information technology (IT) (see, for example, Gaski, 1984). *Channel power*, then, refers to the extent of one channel member's ability to influence decision variables of another channel member at a different level of distribution (see Stern, El-Ansary, and Coughlan, 1996).

Sources of power are those resources that firms can use to influence one another in channel relationships. Power can stem from heavily demanded products, access to target markets, or size. A large retailer has more power than many of its suppliers by virtue of its size because it can, for example, make large-volume purchases (see Keh

¹⁰ Economies of scale are cost advantages that a firm enjoys due to expansion. Economies of scope refer to the reduction of per-unit costs through the production of a wider variety of goods or services.

and Park, 1998: 103).

There are various classifications of sources of power. French and Raven (1959) suggest a taxonomy comprised of coercive, reward, legitimate, expert, and referent power:

- Coercive power is the ability to mete out punishment.
- Reward power is the ability to bestow rewards.
- Legitimate power is based on the target's belief that the actor exercising its power has the right to do so.
- Expert power is based on the target's belief that the actor exercising its power has special knowledge.
- Referent power is based on the target's identification with the power holder.

Applied to distribution channels, such sources of power could stem from the following sources:

- Coercive power: A large retailer, for example, might force a small manufacturer to offer a price discount, indicating that otherwise, no further orders would be made and the small manufacturer's products would not be accepted anymore.
- Reward power: A channel member can positively reinforce another member's performance by providing a price break, paying a fee for additional shelf space, or granting a bonus if a certain goal is met.
- Expert power: Channel members possessing special expertise can persuasively argue about likely sales volumes, market trends, or price levels.
- Legitimate power: Legitimate power usually involves the government granting certain rights to a certain group of channel members.
- Referent power: Referent power stems from the desire to be associated with a certain channel member. A manufacturer may, for example, be highly motivated to ensure the availability of its product at a renowned department store.

Sibley and Michie (1981) dichotomize power sources into two groups: coercive (i.e., punishment-related) and non-coercive (i.e., reward-related) sources. Coercive sources

tend to be potential punishments meted out by one firm as perceived by another (receiving) firm. Coercive power sources are potential and not necessarily actual punishments. These punishments can be used to achieve greater channel member performance. However, there is an inherent danger that they will lower performance levels. The use of coercive power also tends to provoke increased conflict in a dyad.

Non-coercive sources are characterized by a firm's willingness to yield to the influence of another firm. Non-coercive sources often manifest in the form of assistance from one channel member to another channel member, helping the latter perform better. For example, if a manufacturer successfully helps a dealer to administer his/her business, the former establishes him/herself as an expert in the eyes of the latter and thus legitimizes his/her efforts in the channel. The dealer will be more receptive to rewards by the manufacturer.

Brown, Lusch, and Nicholson (1995) adopt a mediated and non-mediated typology. This dichotomy reflects whether the source of power does or does not control the reinforcements guiding a target's behavior. Mediated power sources include rewards, coercion and legal legitimacy, while non-mediated sources of power include expertise, references, information and traditional legitimacy. The use of mediated power will foster instrumental commitment or extrinsic motivation. Empirical evidence suggests that more powerful firms more frequently use mediated power; it also suggests that the excessively frequent use of mediated power is likely to damage the relationship, causing channel conflict. The use of non-mediated power enhances positive attitudes toward channel relationships, elevating normative commitment. Intrinsic factors become more central, whereas extrinsic factors become less important.

A firm does not necessarily have to exercise its influence to have power; it must only possess the ability to do so. The power of a channel member is not a given. Certain structural and industry variables affect the distribution of power, as does the legal and regulatory framework. As Etgar (1976) points out, the dynamics of power relationships can create situations of interdependency. For example, individual retailers that are too small to constitute a threat on their own can form a coalition, threaten to boycott manufacturers and counterbalance those manufacturers' power.

Channel power theory, however, is not universally accepted. Gaski (1984) points out several related methodological problems and conceptual issues as follows.

- Poor operationalization: Power may be an inherently difficult attribute to measure. The idea of the “ability to alter behavior” is hard to operationalize.
- Insufficient evidence of reliability and validity: Most of the research reviewed by Gaski (1984) provides content validity but little else.
- Informant bias: Nearly all research reviews collected data based on key informants. In this methodology, the scientist obtains information about the group under study through a member who occupies a certain role to gain information. Such methodology is, however, extremely undependable, and it may produce biased results.

Nevertheless, the concept of power in distribution channels is frequently encountered in studies of the Japanese distribution system and is therefore worth introducing. In this study, channel power is understood as the ability or potential of a particular channel member to control or influence the decision-making and behavior of one or several other channel member(s).

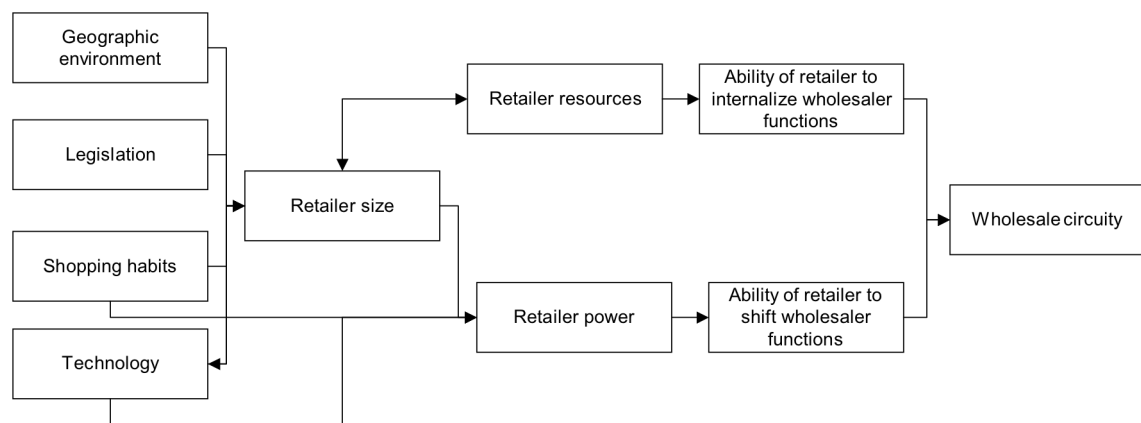
Returning to the question of what factors influence retailer size, we see that *legislation* is only one of a number of factors (see, for example, Treadgold, 1990). Other factors mentioned in the secondary literature are the *geographic environment*, including available space for building retail establishments and roads (see, for example, Flath and Nariu, 1996); *shopping habits*, shaped by consumer preferences, consumption patterns and shopping frequency (see, for example, Fahy and Taguchi, 1991); and *technology*, e.g., the technology of mass production, which has necessitated the establishment of large-scale retailers, or information technology (IT), that can only be efficiently adopted by large-scale retail operations (see, for example, Miwa, 2002).

Shopping habits and technology can also be a source of power. When consumers favor certain retail formats or certain retailers, then the retailers’ channel power increases because their importance as gatekeepers increases. Information technology can also increase retailers’ power. For example, when retailers collect and analyze data on their

customers, they can deduce potentially profitable information from these data and gain an information advantage over manufacturers and wholesalers.

Needless to say, the list of factors affecting retailer size mentioned above is not exhaustive. Firm-specific factors such as decision-making processes, strategy, or organization are not considered at all. While every theoretically reasonable suggestion for a factor can probably be shown to have the predicted impact in some context, the level of complexity at play increases with the number of factors taken into consideration. One way to deal with this complexity (and the approach we take in this study) is to focus on a smaller set of specific factors, as outlined in the framework below, rather than attempting a full explanation.

Graph 1: Conceptual framework



Source: Own graph.

2.2 Research on the Japanese distribution system

2.2.1 Research on distribution systems¹¹

The earliest systematic theories regarding the structure and coordination of distribution channels date back to the early 20th century. Between 1900 and 1950, early institutional economists such as John Commons, Joseph Schumpeter, and Ronald Coase contributed some of the basic concepts and principles that became a foundation for subsequent research. In addition to these more general concepts regarding the structure and coordination of networks, a number of economic principles were defined during that period. These include Margaret Hall's principle of minimized total transaction and Edith Penrose's theory of firm growth.

In the 1960s, two main streams of research emerged, namely studies of the economic structure of distribution channels and studies of the characteristics and evolution of distribution systems and institutions. Towards the end of the 1960s and in the 1970s, the focus of channel research shifted to channel control and the behavioral dimensions of channels. This shift reflected new phenomena in distribution, such as competition among manufacturers and large retailers for channel control or conflicts in franchised distribution systems.

The 1980s introduced a second wave of behavioral studies. The focus was on transaction costs and the nature of the costs of inter-organizational governance. Scholars such as Dixon and Wilkinson linked behavioral dimensions such as power, trust and conflict and economic dimensions to a framework of political economy comprised of multiple actors: internal and external channel politics and an economy that all interacted in various ways.

Last but not least, a number of institutional studies were undertaken that examined the structure and performance of business networks and relationships in different cultural

¹¹ The following overview is based on Wilkinson (2001).

and economic contexts.

The 1990s saw greater integration of various research traditions. Interest in the area of relationships and networks exploded as relationship marketing in industrial and consumer markets emerged, and greater emphasis was placed on cooperative rather than adversarial relations.

Today, we have a better understanding of the efficiencies or economic rationale underlying the division of tasks and the assortment of activities within and between firms in a given distribution system. Governance structures¹² in marketing channels can be analyzed in terms of efficiency and effectiveness. Existing network structures can be understood in terms of trade-offs within and between the efficiencies of alternative operating and governance structures (Wilkinson, 2001: 40-41).

Most models and theories of business networks focus on a comparative static analysis, on the nature of economic equilibriums and on the factors affecting such equilibriums. It is assumed that in the long term, under competitive conditions, an efficient equilibrium structure will somehow emerge. If conditions change and lead to the development of another equilibrium, the network will shift to that new equilibrium in the long run. However, the duration of the “long run” is unclear, and we do not know whether a network will ever reach such an equilibrium or how many possible equilibria may exist.

With the emergence of the Asian economies as world players, research on the nature and role of relationships and networks in Asian cultures has increased, where such features have been assumed to play a prominent role in business (see Wilkinson, 2001: 37). These studies suggest that in networks in Asia, especially in Japan, additional dimensions of relationships are important.

¹² Governance structures are specialized institutional arrangements that arise depending on emergent scope and scale efficiencies.

“Unlike the US and many European nations, the Japanese people and their culture are relatively homogeneous. The traditional values, such as harmony and obedience, as well as the hierarchical structure of nation, employer, and family are upheld with uniformity.” (Samiee and Mayo, 1990: 49)

2.2.2 Salient features of the postwar Japanese distribution system

While there is a wide range of research topics in the area of distribution systems, studies of the Japanese distribution system have centered on understanding and justifying its uniqueness.

“Literature on the Japanese distribution system is extensive in volume, but rather limited in scope. Japanese sources have taken pains to show that the distribution system in Japan has significant cultural and operational objectives that differ from Western models. This has generated a widespread interest in Japanese distribution, but largely through the need to investigate the assertion itself. Concentration of research on the fragmented nature of the overall structure of the system, with the large number of small commercial enterprises exceeding even the number in the United States, has caused the field to be somewhat devoid of broader-based empirical investigations.” (Dawson and Larke, 2004: 774-75)

To review the research on the postwar Japanese distribution system, it is necessary to first introduce and outline the salient features of the Japanese distribution system in more detail, namely the large number of small retailers, the multi-layered wholesale sector, distribution *keiretsu* and specific trade practices.

1. A large number of small retailers

One of the most frequently cited characteristics of the Japanese distribution system as compared to those of other advanced countries is its large number of small retail stores (see Goldman, 1991: 156). Flath (1990) reports that in 1982, there were 145.3 retail stores per 10'000 persons in Japan compared to 82.9 in the United States, 62.7 in the United Kingdom, 74.8 in France and 67.0 in West Germany.

Small-scale retailers are especially prevalent in the food sector, and leading retailers dominate the market much less heavily than they do in the United States and the United Kingdom (Jetro, 2004: 6).

Having a large numbers of small retail stores is regarded as backward and unusual for an economy as advanced as Japan's. As Kikkawa and Takaoka (1998: 102) write, the Japanese retail business structure retains features of quasi- or less-developed economies, featuring many small-sized retail stores that are often family-owned.

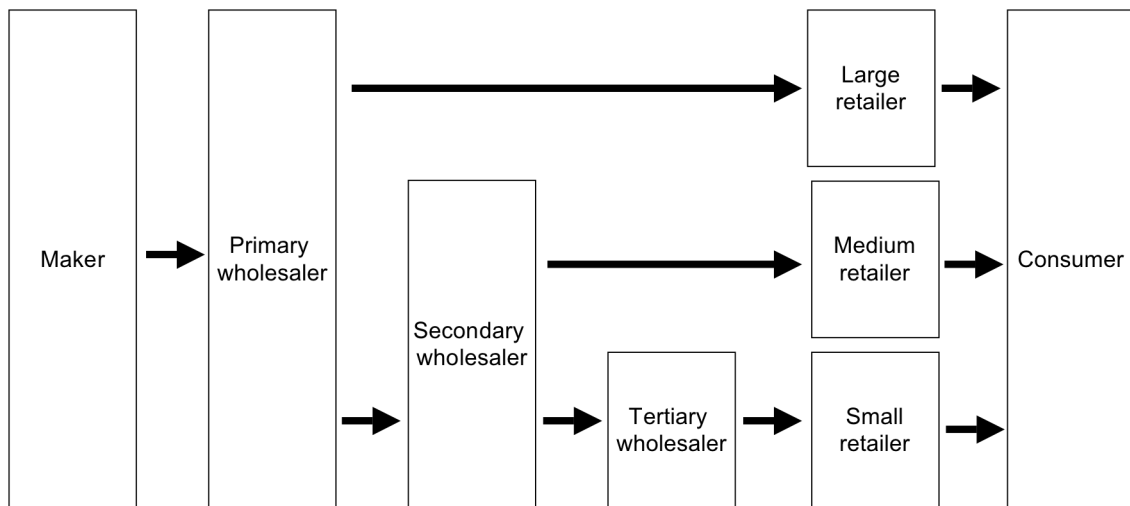
2. A multi-layered wholesale sector

The second salient feature of the Japanese distribution system is its multi-layered wholesale sector. Japanese distribution channels are generally longer and involve more participants than their Western equivalents (see Fahy and Taguchi 1995: 50).

Wholesale organizations not only are large in number but also tend to exhibit an extremely wide range of sizes. Very large and highly integrated general wholesale organizations co-exist with small organizations engaged in the local distribution of one product only. The large and highly integrated general wholesale organizations are also commonly referred to as general trading companies (*sōgō shōsha*). The basic functions of *sōgō shōsha* include trade promotion, market consulting, inventory maintenance, freight forwarding, information gathering, and technology acquisition (Dowd 1959: 260).

Ito and Maruyama (1990) distinguish between primary, secondary and tertiary wholesalers (see Graph 2).

Graph 2: The multi-layered Japanese distribution system



Source: Based on Ito and Maruyama, 1990.

Primary wholesalers may be manufacturer's subsidiaries that deal exclusively with the manufacturer's brand or that deals with brands from various manufacturers. General trading companies (*sōgō shōsha*) are also considered primary wholesalers.

Secondary wholesalers are typically regional distributors. They consolidate a variety of goods purchased from primary wholesalers and distribute the merchandise to medium-sized retail outlets and/or to a vast network of sub-wholesalers (i.e., tertiary wholesalers). Although many secondary wholesalers are sizeable, they fail to buy directly from manufacturers because of the exclusive rights of primary wholesalers (see Kikuchi, 1994: 2).

Tertiary wholesalers are typically local distributors. They deliver a wide assortment of goods in small quantities to so-called "mom-and-pop" stores. They also maintain large inventories, make quick deliveries, accept unsold goods, and send some of their employees to help promote special sales for mom-and-pop stores (see Ito and Maruyama, 1990; Fahy and Taguchi, 1995).

Table 1 shows the official classification system developed by the Japanese Ministry of Economy, Trade and Industry (METI), which distinguishes between primary and secondary wholesalers. Direct trade wholesalers and source wholesalers are sub-

categories of primary wholesalers, while direct trade wholesalers and direct trade wholesalers that serve retailers in particular are sub-categories of direct trade wholesalers. Intermediate wholesalers and final wholesalers are sub-categories of secondary wholesalers.

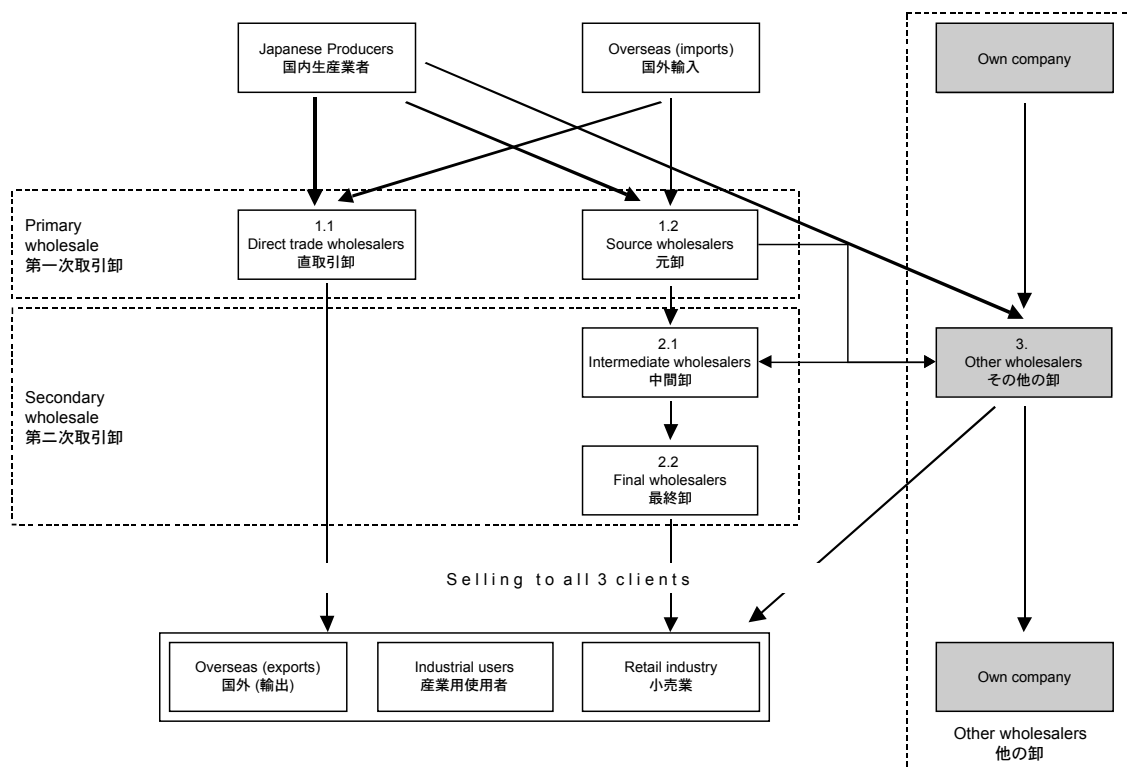
Table 1 and Graph 3 provide an overview of the official classification of Japanese wholesalers and the distribution routes. The terminology adopted in this work matches this official classification.

Table 1: The official classification of Japanese wholesalers and distribution routes

Wholesale level	Distribution route (sourcing from)	Distribution route (selling to)
1. Primary wholesale		
第一次卸		
1.1 Direct trade wholesalers 直取引卸		
1.1.1 Direct trade wholesalers 他部門直取引（取引先が他の産業である直取引卸）	Sourcing from producers 生産業者から仕入れ	Selling to industrial users 生産使用者へ販売
	Sourcing from producers 生産業者から仕入れ	Selling to overseas 国外へ販売
	Sourcing from overseas 外国から仕入れ	Selling to industrial users 生産使用者へ販売
	Sourcing from overseas 外国から仕入れ	Selling overseas 国外へ販売
	Sourcing from overseas 外国から仕入れ	Selling overseas 国外へ販売
1.1.2 Direct trade wholesale to retailers 小売直取引（販売先が小売業者である直取引卸）	Sourcing from producers 生産業者から仕入れ	Selling to retailers 小売業者へ販売
	Sourcing from overseas 外国から仕入れ	Selling to retailers 小売業者へ販売
	Sourcing from overseas 外国から仕入れ	Selling to retailers 小売業者へ販売
1.2 Source wholesalers 元卸	Sourcing from producers 生産業者から仕入れ	Selling to wholesalers 卸売業者へ販売
	Sourcing from overseas 外国から仕入れ	Selling to wholesalers 卸売業者へ販売
	Sourcing from overseas 外国から仕入れ	Selling to wholesalers 卸売業者へ販売
2. Secondary wholesale level		
第二次卸		
2.1 Intermediate wholesalers 中間卸	Sourcing from wholesalers 卸売業者から仕入れ	Selling to wholesalers 卸売業者へ販売
2.2 Final wholesalers 最終卸	Sourcing from wholesalers 卸売業者から仕入れ	Selling to industrial users 生産使用者へ販売
	Sourcing from wholesalers 卸売業者から仕入れ	Selling overseas 国外へ販売
	Sourcing from wholesalers 卸売業者から仕入れ	Selling to retailers 小売業者へ販売
	Sourcing from wholesalers 卸売業者から仕入れ	Selling to retailers 小売業者へ販売
3. Other wholesalers		
その他の卸		
3.1 Wholesalers selling goods to their own company 販売先が同一企業である卸	Sourcing from producers 生産業者から仕入れ	Selling to the head office / branches of their own company 同一企業内の本支店へ販売
	Sourcing from the parent company 生産業者のうち親会社から仕入れ	Selling to the head office / branches of their own company 同一企業内の本支店へ販売
	Sourcing from other producers 生産業者のうちその他の生産業者から仕入れ	Selling to the head office / branches of their own company 同一企業内の本支店へ販売
	Sourcing from wholesalers 卸売業者から仕入れ	Selling to the head office / branches of their own company 同一企業内の本支店へ販売
	Sourcing from overseas 外国から仕入れ	Selling to the head office / branches of their own company 同一企業内の本支店へ販売
3.2 Wholesalers purchasing goods from their own company 仕入先が同一企業内である卸	Sourcing from the head office or branches of their own company 同一企業内の本支店から仕入れ	Selling to the head office or branches of their own company 同一企業内の本支店へ販売
	Sourcing from the head office or branches of their own company 同一企業内の本支店から仕入れ	Selling to wholesalers 卸売業者へ販売
	Sourcing from the head office or branches of their own company 同一企業内の本支店から仕入れ	Selling to retailers 小売業者へ販売
	Sourcing from the head office or branches of their own company 同一企業内の本支店から仕入れ	Selling to industrial users 生産使用者へ販売
	Sourcing from the headquarter or subsidiary 同一企業内の本支店から仕入れ	Selling overseas 国外へ販売
	Sourcing from the headquarter or subsidiary 同一企業内の本支店から仕入れ	Selling overseas 国外へ販売
3.3 Wholesalers selling goods manufactured in own establishment 自店内製造品の販売	Sourcing goods produced in own establishment 自店内製造品を仕入	Selling goods to head office or branches their own company 同一企業内の本支店へ販売
	Sourcing goods produced in own establishment 自店内製造品を仕入	Selling to wholesalers 卸売業者へ販売
	Sourcing goods produced in own establishment 自店内製造品を仕入	Selling to retailers 小売業者へ販売
	Sourcing goods produced in own establishment 自店内製造品を仕入	Selling to industrial users 生産使用者へ販売
	Sourcing goods produced in own establishment 自店内製造品を仕入	Selling abroad 国外へ販売
	Sourcing goods produced in own establishment 自店内製造品を仕入	Selling abroad 国外へ販売

Source: The Ministry of Economy, Trade and Industry (METI).

Graph 3: The official classification of Japanese wholesalers and distribution routes



Source: The Ministry of Economy, Trade and Industry (METI).

Fahy and Taguchi (1995: 50) have reported that in the 1980s, Japan featured an average of 2.21 wholesaler steps between producers and retailers, while the United States, France, and the former West Germany averaged 1.0, 0.73, and 0.90, respectively. This means that Japanese wholesalers sold their goods twice as frequently to other wholesalers as did their counterparts overseas. Therefore, total wholesaler sales volume was larger in Japan than in other countries. Min (1996: 23) reports that in 1988, total wholesaler sales volume in Japan was estimated to be 3.1 times total retail sales volume, while United States' wholesaler sales volume was about the same as retail sales volume.

Longer wholesale marketing channels with more participants than in the Western

countries translate into a larger number of wholesale steps¹³ and more frequent trading between wholesalers (see Nariu and Flath, 1993: 95; Fahy and Taguchi, 1995: 50; Min, 1996: 23).

The contribution of each player's additional margin is frequently cited as one reason for elevated consumer prices in Japan (see Fahy and Taguchi, 1995: 50). Frequent trading among wholesalers is also considered to represent a major entry barrier for Japanese and foreign players. According to Min (1996: 23), unlike the typical US distribution channel, which is open, independent, and margin-driven, the Japanese distribution channel can be characterized as a long, complicated network of relationship-driven middlemen who closely interact with fellow-trade wholesalers, brokers, manufacturers, importers, and retailers.

3. Distribution *keiretsu*

The tendency of manufacturers to play a more dominant rule in the distribution of their products was accentuated in a number of industries after World War II and resulted in what is referred to as distribution *keiretsu*. Distribution *keiretsu* prevail, although not exclusively, in consumer electronics, household appliances, and pharmaceuticals (see Fahy and Taguchi 1995: 50-51). Overall, however, independent or non-*keiretsu* distribution channels are more common than *keiretsu* distribution channels.

According to Kunitomo (1997: 887), *keiretsu* manufacturers sell products only to wholesalers that belong to their own business groups, and the wholesalers sell mainly to retail outlets in their business group.

Ishida (1983: 322) defines distribution *keiretsu* as:

“Systematic or interrelated efforts by manufacturers (and wholesalers) to organize retail dealers in order to promote cooperation as well as to force them to carry out producer-determined policies at the retail level.”

¹³ The concept of the “number of wholesale steps” refers to the number of separate title-holding intermediaries interposed between a manufacturer and retailers or between industrial purchasers. See Nariu and Flath (1993: 91-92).

Distribution *keiretsu* exist in multiple industries, not just in the consumer goods industry. Some manufacturers of industrial goods also set up *keiretsu* groupings to distribute their goods. Ishida (1983: 323) has defined a distribution *keiretsu* in the consumer goods market as opposed to an industrial or horizontal *keiretsu*¹⁴ as follows:

“The term ‘distribution *keiretsu*’ is used to describe the organization and control of channels of distribution by a particular manufacturer. As in the case of industrial *keiretsu*, wholesale and retail outlets in a *keiretsu* grouping become integrated by means of a variety of ties or links. Distribution *keiretsu* differ from industrial *keiretsu*, however, in that there is no question as to who controls them. It is the manufacturer.”

According to Niida (2002), the formation of the *keiretsu* distribution system in the consumer goods industry system took place between 1955 and 1965. One of the best-known distribution *keiretsu* is the Matsushita distribution *keiretsu*. Matsushita, together with Sanyō, Sharp, Hitachi, Tōshiba, Mitsubishi, and Fuji, belonged to the group of so-called “general appliance manufacturers.” These manufacturers produced a wide range of appliances, including the three highly sought-after appliances (washing machines, refrigerators, and black-and-white TV sets) that became popular from 1953 onwards (see Niida 2002: 81). All manufacturers were successful in establishing mass production systems by building specialized factories for each different product, strengthening a subcontractor system for module-based production (also called production *keiretsu*), and continuing to develop new appliances. However, they found it difficult to market these new products (see Niida 2002: 82-83). Most (though not all) of the general appliance manufacturers set up *keiretsu* distribution systems to cope with this challenge.

Manufacturers have adopted different strategies to organize distributors at the wholesale and retail levels:

¹⁴ Horizontal *keiretsu* are usually organized around a bank and consist of a variety of companies that perform different functions in diverse fields.

- **Exclusivity at the wholesale level:** Manufacturers incorporate existing wholesale establishments into their exclusive distribution system by (a) becoming major shareholders, (b) offering financial support, and (c) providing temporary staffing. Wholesalers are consolidated by district and are operated as exclusive sales outlets that will not handle the products of other manufacturers.
- **Non-exclusivity at the retail level:** A *keiretsu* retailer can sell another manufacturer's products, but the ratio of *keiretsu* product sales generally exceeds 60%. The retailer has to display the manufacturer's signage to be easily identified as a *keiretsu* store (see Niida, 2002: 83ff). Manufacturers generally have two requirements, namely that retailers:
 - Make a conscious effort to increase sales volume for the manufacturer's brand.
 - Increase customer satisfaction.

When the United States tried to correct its trade imbalance with Japan, distribution *keiretsu* became one focus of attention. Japanese manufacturers were blamed for excluding foreign manufacturers by locking up existing distributors in their *keiretsu*. It was argued that through these networks, they maintained extraordinarily opaque relationships characterized by customary norms involving trade support, price concessions, return policies, and even seconded employees; in addition, they imposed contractual terms that excluded rivals, both foreign and domestic (see Miwa and Ramseyer, 2001: 3-4).

Various studies have confirmed that the existence of distribution *keiretsu* has had an effect on the ability of foreign companies to enter the Japanese market and has influenced their means of entry (see, for example, Nagaoka and Goto, 1997). Lawrence (1991) identifies both horizontal and vertical types of *keiretsu* as reducing imports.¹⁵

¹⁵ The vertical *keiretsu* is usually composed of a major industrial corporation and its suppliers or distributors and/or retailers in a particular industry, such as automobiles or electronics. Vertical *keiretsu* can be further subdivided into supply *keiretsu* and distribution *keiretsu*. Supply *keiretsu* are groups of companies that are integrated along a supply chain dominated by a major manufacturer such as Toyota, Nissan, Tōshiba, or Hitachi. In contrast to supply *keiretsu*, which share interlocking interests with their upstream suppliers, distribution *keiretsu* develop a web of relationships with their downstream distributors and retail outlets.

Flath (2002b) identified an empirical relationship between foreign direct investment (FDI)¹⁶ in Japanese wholesaling, distribution *keiretsu* and import penetration. The same applies to the Japanese retail market: wholesale marketing channels for consumer products tend to employ more foreign wholesale affiliates, and those that feature more retail outlets tend to have lower import penetration rates. This indicates that impediments to foreign exporters in Japanese wholesaling may still be present in 1997. Flath (2002b) further reports that about one-third of the 1'372 large foreign subsidiaries operating in Japan in 1997 were primarily engaged in wholesaling. Wholesale affiliates of foreign firms comprise a significant portion of the stock of foreign direct investment in Japan. At the same time, import penetration itself is less likely in these markets. Almost 90% of imports into Japan involve foreign purchases by Japanese wholesale establishments. Foreign purchases by general trading companies amounted to 19 trillion yen and accounted for a little more than half of all foreign purchases by Japanese wholesalers in 1997.

Flath (2002b) concludes that marketing channels in Japan with a higher incidence of distribution *keiretsu* are more likely than others to include wholesalers that are subsidiaries of foreign manufacturing companies. In other words, the foreign penetration of Japanese product markets that feature distribution *keiretsu* is likely to be accompanied by direct investment. Foreign affiliates in Japan's wholesale industries are heavily concentrated in a few lines of business, including machinery, medical instruments, precision instruments, automobiles, automobile parts, electric appliances, and toiletries.

¹⁶ In comparison with that of other industrial countries, the foreign direct investment (FDI) flowing into Japan in recent years has been very limited in proportion to the gross national product (GNP). It is also very limited in comparison to the outflow of FDI from Japan. From a cumulative table indicating the outflow of FDI during the years from 1990 to 1996, we see that Japan is in fourth position behind the United States, the U.K., and France, but in a cumulative table for inflowing FDI during the same period, Japan ranks 21st behind countries like New Zealand, Switzerland, Portugal, Poland, and Hungary. A study by the Japan Development Bank shows that the outflow of FDI from Japan in the 1990s was 15.5 times greater than the inflow of FDI into Japan.

4. Specific trade practices and symbiotic relationships

The fourth salient feature of the Japanese distribution system is the use of certain trade practices by channel participants. Fahy and Taguchi (1995: 50) have listed the following most common trade practices:

- ***Henpin*** is a liberal return policy that extends not only to damaged goods but also to products that are not selling well. Retailers can return goods to manufacturers through wholesalers.
- ***Tegata*** (or promissory notes) are a form of buyer credit that is good for up to 120 days.
- ***Tatene*** (or resale price maintenance, RPM) is a mechanism through which manufacturers determine the final price that retailers must charge consumers.
- **Rebates** are issued to wholesalers and retailers for meeting sales targets, paying on time, following manufacturer pricing policies, or adopting certain marketing techniques. They may also be offered as compensation for loyalty to a manufacturer. Rebates are negotiated privately with each intermediary and are not based on objective criteria.

Trade practices are applied within both distribution *keiretsu* and independent or non-*keiretsu* distribution channels. They have attracted substantial attention both from the Japanese Fair Trade Commission (JFTC)¹⁷ and from Western countries. While these practices are regarded as potentially advantageous for the Japanese parties involved, foreign firms consider them a disadvantage when doing business in Japan. Sletmo and Ibghy (1991) write that distribution in Japan relies extensively on practices that are viewed as illegal under North American and European competition legislation.

The practice of *tatene* (or resale price maintenance agreement, RPM) has been heavily criticized in particular. In Japan, resale price maintenance falls under the category of

¹⁷ The Japan Fair Trade Commission enforces the Antimonopoly Act to maintain fair and free competition in Japan. See www.jftc.go.jp.

unfair trade practices prohibited by Section 19 of the Antimonopoly Act (AMA, the Japanese Competition Law) and is therefore illegal (see OECD, 1997). The AMA exempts certain cases under specific conditions from the general prohibition on RPM. The system for exempting certain types of RPM was introduced in 1953 (see Yoshino 1971: 119ff). Since the middle of the 1960s, the JFTC has at several times repealed some of the designated commodities. As the JFTC began to reduce the number of products for which resale price maintenance was allowed, some producers of these products began to develop and strengthen distribution *keiretsu* arrangements as a means of maintaining vertical price-fixing on a de facto basis (see Ishida 1983: 323).¹⁸

Tatene is seen as a potent weapon for manufacturers to establish and maintain control over distribution channels. Yoshino (1971: 120) writes that large manufacturers engage in covert attempts to control prices and terms of sales at various levels in the channel, even in those industries in which RPM is not legally permitted. He further writes that the power of large manufacturers in comparison with distributors is substantial and that they are in the position to exert strong pressure on recalcitrant companies. They can even refuse to sell to non-responsive distributors. Enforcement of the Anti-Monopoly Act is generally low, but the JFTC has intervened in some cases, as in 1967 when it accused Matsushita Electric of specifying the wholesale price and rebate structure to be followed by the outlets under its control and refusing to ship products to violators (see Yoshino, 1971: 123).

According to Fahy and Taguchi (1995: 52), manufacturers exert pressure on channel participants if necessary. Manufacturers' emphasis, however, is on maintaining friendly and close personal relationships with channel members. These relationships are nurtured by frequent visits, gifts, and support in difficult times. The maintenance of the relationship is considered more important than sales levels. Such close relationships represent a particularly difficult barrier for new or foreign suppliers to overcome. Kennedy (1993) concludes that distribution channels in Japan, with their multiple

¹⁸ For an explanation of the economic logic behind resale price maintenance, see Flath and Nariu (2000).

layers of wholesalers that have developed close, personal relationships with other wholesalers, manufacturers, importers, and retailers, are as inefficient as they are complex. For Verity (1988), the Japanese distribution system is essentially a product of Japan's traditional way of doing business; it includes an emphasis on close personal contact, trust in initiating business dealings, and meticulous after-sales service. Because they seek to maintain friendly ties with their suppliers, retailers hesitate to disrupt their longstanding personal relationships with Japanese suppliers, even when foreign companies offer superior products or price differentials. They fear a perceived lack of sincere commitment, breakdowns in communication, or reprisals from long-term partners if they are found to sell foreign products (see Martin, Howard, and Herbig, 1998).

2.2.3 Explaining the Japanese distribution system

Studies of the Japanese distribution system - both in Japanese and in other languages - are too numerous to be reviewed. Research on the Japanese distribution system can roughly be divided into two major perspectives, namely the cultural view and the economic view. The economic view interprets the Japanese distribution system (or certain aspects of it) as an efficient adaptation to Japan's legal, social, economic and/or geographic environment. For proponents of the cultural view, the structure and inner workings of the Japanese distribution system are a result of Japanese tradition and culture. Japanese trade practices, for example, are seen as being heavily shaped by tradition and culture (see Marvel, 1993: 156ff). Although inefficient, they are immutable and slow to change (see Kitchell, 1995: 199). These practices have survived because group harmony, long-standing hierarchical relationships, and social obligations are more important in Japan than short-term profitability.

Samiee and Mayo (1990: 48) write that social considerations encompass personal relationships that frequently precede commercial transactions. According to Martin, Howard, and Herbig (1998), strong personal relationships between channel members and the pooling and sharing of information have their roots in traditional rural village life, where the planting, irrigation and harvesting of rice were activities that had to be

collaborative. The channel members are part of a family (*ie*) and are as tightly interlocked by tradition as they are by emotion. Eliminating a channel member is regarded as a traumatic and tragic decision. The eliminated channel members may be unable to bear the social consequences of the resultant damage to their pride. Thus, small and inefficient channel members are often retained and tolerated. Goldman (1991: 165) writes that in Japan, distribution activities are viewed as a subset of social, personal and political activities rather than as a separate sphere. Non-economic considerations are a legitimate part of decision-making. Performance is not exclusively evaluated in economic-functional terms. Because of the importance of tradition, the fact that a certain practice or arrangement exists in itself justifies its continuation. Goldman attributes the dominance of manufacturers to the various types of social and economic power that are rooted in Japanese values. In accordance with the Chinese- and Confucianism-inspired four-tiered caste system (*shinōkōshō*) introduced in Tokugawa Japan (1603-1868)¹⁹, not only did the manufacturing class enjoy higher prestige than the merchant class, but the hierarchical-vertical authority structure and group loyalty also further strengthened the position of manufacturers as channel leaders.

According to Samiee and Mayo (1990), Japanese culture emphasizes friendship, trust, a

¹⁹ In 1615 a Chinese-inspired four-tiered caste system known as *shinōkōshō* (“warrior-peasant-artisan-merchant”) was introduced in Japan. At the top was the samurai class, responsible for all military and political functions and accounting for about 6% of the population. Peasants were regarded as the essential producers, and consequently, they ranked higher than artisans and merchants. The justification for this higher ranking was that peasants nurtured the country and thereby provided income for the samurai. Peasants accounted for the bulk of the population. The artisans produced material objects and were therefore seen as more useful than the merchants. Because merchants “only” moved objects around and made them available for purchase, they were considered the least important of the classes (see Henshall, 1999: 51). Within each class, there were various sub-rankings. Court nobles, priests, nuns, doctors, and professional teachers were outside the classes (see Crawcour, 1989: 571), and below the four aforementioned classes were two outcast sub-classes, namely, the *eta* (roughly translated as “great filth”) and *hinin* (i.e., non-people). They engaged either in “impure” activities such as butchering or burial or in suspicious activities such as peddling and acting (see Henshall, 1999: 51). To maintain social order, movement between the classes was prohibited, and status was hereditary (see Sheldon, 1983: 477). Movement between classes, however, was not impossible as popularly believed (see Henshall, 1999: 51). Regulations dictated the details of everyday life, such as type and place of work or residence, type of clothing, what type of gift a person of a particular class could give to others, and what types of food he/she could eat. In theory, the feudal restrictions were the most far-reaching for the peasant class and most restrictions affected their daily lives. Peasants were not allowed to move, change professions, sell arable land, partition holdings into parcels smaller than a certain minimum, or change their crops at will; in addition, they were ordered not to eat much rice and never to use silk, never to purchase tea and sake, and never to live in a luxurious home (see Miyamoto, Sakudo, and Yasuba, 1965: 542). Each individual was expected to play the role that was consistent with his or her birth and occupation.

long-term view of events and relationships, respect for seniority, and the maintenance of harmony. Long-term relationships are cultivated by deeply rooted tradition and reciprocity in gift-giving, including practices such as *ochūgen* and *oseibo*.²⁰

Samiee and Mayo (1990) also write that in the context of the distribution system, the various forms of distribution channel rebates are also governed by reciprocity.

“The process of reciprocity is widespread throughout the society and, coupled with strong yet nationalistic sentiments, may partly explain the less-than-speedy trade liberalization by the Japanese government.” (Samiee and Mayo, 1990: 50)

More generous rebates commensurate with the channel member’s level of dedication to manufacturers or wholesalers.²¹ Long-term relationships are encouraged by Japanese customs despite the fact that there may be high costs in the short term. Decision-making is socially rather than economically driven, and historical practices are perpetuated into the future (see Pirog III and Lancioni, 1996: 56).

Because cultural variables are immutable or slow to change, the proponents of the cultural view argue that market entrance can only be secured through coercion (see Kitchell, 1995: 199). Czinkota and Woronoff (1991) write that import promotion policies are implemented by the Japanese government to appease trade partners and target Japanese corporations and individual consumers as buyers of imported products and foreign firms as potential sources of exports to Japan. However, these policies

²⁰ *Ochūgen* refers to the custom of gift giving at midsummer and to the gifts themselves. Traditionally an occasion upon which offerings to the souls of the deceased were distributed to a family and others to share symbolically divine qualities among the mortals, this custom has since become secularized. Gifts are no longer offerings to the souls of the deceased but are instead purchased at a store and directly delivered to a family. *Ochūgen* gifts are never given within a family. Similarly, *oseibo* refers to the custom of giving year-end gifts. The gifts are an expression of appreciation for favors received in the past year. *Ochūgen* and *oseibo* are formally prescribed expressions of social obligations, and although the gifts are voluntary, the givers know that they are given under social obligation.

²¹ The analogy drawn between the custom of gift giving and distribution channel rebates, however, is not correct. Neither *ochūgen* nor *oseibo* is reciprocal as Samiee and Mayo suggest (1990). Gifts flow one way only, from “inferiors” to “superiors.” There are no mutual exchanges, and there is no expectation of specific returns. In the corporate world, the flow of gifts also follows hierarchical principles. Large companies receive gifts from their subsidiaries, while small business give gifts to large companies upon which they depend (see Creighton, 1991: 679-680).

make little sense because distribution impediments are deeply rooted in the political, social and economic institutions in Japan, where little change can be expected (see Greaney, 2001: 254). Changing the Japanese distribution system would first and foremost require a change in customs and tradition.

The cultural view has been criticized as overly simplistic, over-used and outdated (see Kitchell, 1995: 199-200). Marvel argues (1993: 156ff) that if the Japanese distribution system had simply survived as a result of custom and tradition, Japanese manufacturers would not have established similar distribution arrangements in geographically unfamiliar and culturally different markets such as the United States. There must be an economic logic behind the structure and trade practices of the Japanese distribution system because, as Miwa and Ramseyer (2001: 3) write, other firms (including foreign firms) should earn large profits by replacing wholesalers and retailers if the latter two act inefficiently.

Based on this reasoning, the proponents of the economic view offer a wide range of explanations for the salient features of the Japanese distribution system:

1. Explaining the large number of small retail stores: The main explanation proposed for this is that the Japanese distribution system has been shaped by its institutional framework and, specifically, the Large-Scale Retail Stores Law. Tamura (1986) can be viewed as the main proponent of this view. His work is regarded as one of the most outstanding Japanese studies of the Japanese distribution system. He is also widely considered to have set the standard for inquiries into Japan's distribution system from the perspective of commercial science (see Kikkawa and Takaoka, 1998: 102). According to Tamura (1986), the structure of the Japanese retail business, with its abundance of small retail stores, was shaped and maintained by the presence of institutional mechanisms: i.e., the Large-Scale Retail Stores Law.

According to Patrick and Rohlen (1987), the Japanese tax system of the 1980s further favored the continued operation of small stores, even when their operation was not profitable. Firstly, several loopholes in the Japanese tax system allowed family-run stores to substantially reduce their income tax burden. A licensed tax accountant was not required when shop owners reported their business income. This was believed to

result in inflated expenses and under-reported sales. Secondly, taxes could be avoided because of the ambiguous distinctions between household consumption and business expenses. The actual income of shop owners was probably much higher than reported. Third, tax deductions for inherited land (if less than 200 m²) used for business purposes were higher than those for land used for residential purposes. For a store adjacent to a residential space (as is the case for most family-run stores), 40% could be deducted for store space and 20% could be deducted for residential space. This rate generated a considerable difference in tax savings, especially in the 1980s, when land prices skyrocketed.

Proponents of the applied microeconomic theory explain the structure of the Japanese distribution system in terms of consumer behavior or the limited ability of consumers to perform distributive tasks.

- **Frequent and small purchases:** Shopping habits in Japan differ from those in Europe and the United States. A food shopper in the United States is likely to visit a retail store approximately 1.8 times per week, while his/her Japanese counterpart visits five times a week. Japanese consumers purchase goods in small quantities and at frequent intervals because of the relatively small size of conventional Japanese dwellings, which makes stockpiling at home extremely expensive. Consumers must replenish perishable stocks of food and other products frequently and therefore demand convenient local (and hence, small) outlets (see Flath and Nariu, 1996: 190). In addition, Japanese consumers place a significant emphasis on freshness and quality (see Fahy and Taguchi, 1991: 50). Japanese households value next-door shopping, which enables them to make more frequent shopping trips, maintain low household inventories, and economize on scarce living space (see Flath and Nariu, 1996: 190).
- **Meeting high service demands:** Small mom-and-pop stores provide excellent personal service. Customers expect guidance from retailers in product selection and other pre- and post-sale services (see Fahy and Taguchi, 1995).
- **The low prevalence of private motor vehicles versus the high number of commercial vehicles:** The number of private motor vehicles per person in Japan is

among the lowest of all developed countries. The low incidence of private car ownership contributes to the high costs of transporting goods from stores to dwellings and promotes a greater density of retail outlets. In contrast, Japan has the greatest number of commercial vehicles per person. According to Flath and Nariu (1996), the superabundance of commercial vehicles implies that the added transportation costs of restocking multiple small stores as opposed to a smaller number of large outlets are less substantial in Japan than they would be in other nations. The costs of restocking are also low because most of the population resides along the coastal plains, which further contributes to the profusion of retail stores. A retail structure dominated by large superstores would waste resources and not economize as many have claimed (see Flath and Nariu, 1996: 190-191).

A further explanation is that the distribution sector **absorbs** a large share of the **surplus labor force**. During the pre-war and early postwar years, unemployment was one of the most serious and persistent problems in Japan. A large number of unskilled laborers that would have been otherwise unemployed entered the commercial sector, especially the retail sector. This greatly increased the number of small establishments, both wholesale and retail (see Yoshino, 1971: 24).

2. Explaining the multi-layered wholesale sector: A conventional explanation for the multi-layered wholesale structure is the large number of small-scale retail stores (see Flath, 2003: 3). Both the proponents of the institutional approach and those who support the applied microeconomics approach view the multi-layered structure of the wholesale sector as being linked to the high density of retail stores.

“The multiplicity of the wholesale steps for consumer goods in Japan is statistically linked to the ubiquity of retail stores selling the same products, which suggests that Japan’s ubiquity of stores and complexity of wholesaling have a common basis.” (Nariu and Flath, 1993: 95)

Others attribute the continued existence of long distribution channels to the dominance of wholesalers and their use of control mechanisms such as vertical integration, financial linkage, and reciprocal dealings (see Min, 1996: 23). According to Torii and

Nariu (2004: 5), this view implicitly and wrongly presumes that middlemen provide no valuable services and merely add to the cost of marketing.

Japanese wholesalers reportedly serve the following functions:

- **Bridging the information gap between manufacturers and small retailers:** Wholesalers mediate between producers and retailers and bridge the information gap between the two. Retailers, for example, do not necessarily know which producer is providing each commodity. Neither do producers know the specific requirements of each retailer (see Torii and Nariu, 2004: 6). Wholesalers in particular are required to bridge the information gap when producers and retailers are small and numerous, as is frequently the case in Japan. In contrast, when a large-scale producer establishes its own brand and most of the retailers come to know the merchandise it produces, the information gaps between producers and retailers becomes small, and wholesaling has little to contribute. For large-scale retail stores, wholesaling also loses its importance, and information bridging between producers and retailers need not to be accomplished by wholesalers (see Torii and Nariu, 2004: 6).
- **Standardizing production output:** The majority of manufacturers producing consumer goods in Japan are small. Due to a lack of reliable production schedules and uniform quality standards, a large number of middlemen are needed to supply small manufacturers according to their needs and to assemble and distribute their products (see Yoshino, 1971: 24-25).
- **Serving the large number of small retailers:** Because the majority of Japanese retail stores is small and suffers from severe space constraints, the sector demands and relies on timely, frequent deliveries and minimal inventories.
 - **Small deliveries:** Through a multi-layered channel, downstream final wholesalers can afford to make small deliveries of less-than-truckload quantities on a frequent basis via non-conventional modes of transportation such as bicycles and motor scooters.
 - **Rapid deliveries:** The multi-layered wholesale channel links wholesalers to

single-store retailers throughout the Japanese islands and, through quick negotiations and bulk breaking, helps move the product rapidly from production to retail and consumption.

- **Streamlined customer services:** The close linkages between multi-layered channel members encourage the sharing of information on product trends, innovations, competition, and overall market opportunities. This helps the Japanese retailer to provide more streamlined customer service (see Torii and Nariu, 2004).

3. Explaining the distribution *keiretsu*: The explanations offered for the existence of distribution *keiretsu* are as follows.

- **Minimizing transaction costs:** Distribution *keiretsu* provide an effective system for minimizing transaction costs. Dealing with well-known partners reduces the cost of gathering information, monitoring, and negotiation (see Fahy and Taguchi, 1995: 52).
- **Lower competition:** Distribution *keiretsu* are a response to intense competitive pressures. Through *keiretsu* networks, manufacturers control prices and re-impose stability on the market. Through the so-called “*keiretsufication*” of external wholesalers and retailers, manufacturers encourage exclusivity. In addition, the provision of information, training, and monetary assistance solidifies the formation of close business relationships. The needs of manufacturers in terms of market share and stable prices match the needs of weak wholesalers and retailers in terms of protection from price wars (see Shimotani, 1995).
- **Curbing agent opportunism:** Distribution *keiretsu* are effective and efficient structures for monitoring agent behavior (see Lassar and Kerr, 1996: 615).
- **Capitalizing quickly on new market opportunities:** Distribution *keiretsu* are effective in responding to new market opportunities by sharing and transferring information and technology among members (see Milgrom and Roberts, 1994).
- **Stabilizing supply:** *Keiretsu* manufacturers can assure their downstream distributors and retailers a constant supply of the necessary merchandise through

exclusive contracts. Such merchandise often includes high-quality brand-name products that many Japanese consumers tend to favor over non-branded options. Furthermore, *keiretsu* distributors and retailers are likely to adapt their delivery schedule to the requirements of their customers on a stable basis (see Milgrom and Roberts, 1994).

- **Sharing financial risk:** Through mutual shareholding, distribution *keiretsu* encourage their members not to worry about hostile takeovers and thus focus on long-term interests such as new product marketing and distribution. Also, many manufacturers traditionally provide *keiretsu* members with several forms of financial assistance, such as credit extensions, the acceptance of promissory notes with deferred payments, discretionary rebates, and return privileges for unsold products at no cost. Such assistance helps *keiretsu* members survive tough financial times (see Milgrom and Roberts, 1994).
- **Mass marketing of mass-produced products:** Manufacturers organize *keiretsu* distribution channels to mass-market their mass-produced products. Establishing one's own distribution *keiretsu* is profitable, even if it involves a large investment (see Ishida, 1983: 323).
- **Differentiating through customer service:** By providing comprehensive marketing and technical services such as product-information provisions and after-sales services, distributors can build customer loyalty regarding new or unfamiliar products from their manufacturers, thereby better differentiating the manufacturer's brand from that of its competitors (see Niida, 2002, 82ff).

Being part of a manufacturer's *keiretsu* network involves various incentives for wholesalers and retailers as follows.

- **Marketing and technical assistance from manufacturers:** Wholesalers depend on marketing and technical assistance from manufacturers to offer product information and sufficient after-sales services to customers for a large number of new products.
- **Attractive preferential treatment:** Manufacturers grant attractive sales

commissions, financial assistance in the form of advertising, and/or rebates based on the manufacturer's product sales as a percentage of total sales to all the wholesalers that are part of their *keiretsu* network.

- **Enhanced consumer confidence and loyalty:** Retailers can enhance consumer confidence and loyalty by relying on the products of a well-known manufacturer (see Niida, 2001: 85).

4. Explaining specific trade practices: Specific trade practices increase the overall efficiency of the distribution system in various ways (see Fahy and Taguchi, 1995: 50).

- **Reduce risks:** The retailer can return unsold goods to the wholesaler (*henpin*). This eliminates the risks and costs of unsold stock for local small-scale shops. Small retailers can offer a wide product range without the risk of large, unsold inventory.
- **Avoid cash flow problems:** *Tegata* (or promissory notes) help the buyer to avoid cash flow problems for slow-selling products.
- **Stabilize the system:** The recommended resale prices (*tatene*) set by the manufacturer incorporate given profit margins for each intermediary, thereby providing stability for the system.
- **Incentivize channel members:** Rebates encourage wholesalers and retailers to reach particular sales targets, pay on time, follow manufacturer pricing policies, and/or adopt marketing techniques; in short, these rebates compensate for loyalty to the manufacturer (see Fahy and Taguchi, 1995: 50; Marin, Howard, and Herbig, 1998).

2.2.4 Summary

In this section, we have reviewed the vast body of research describing and explaining the salient features of the Japanese distribution system. We find the idea that the postwar Japanese distribution system has been heavily shaped by Japan's institutional framework, above all the Large-Scale Retail Stores Law, provides the dominant explanation both inside and outside Japan. The statute that allegedly protected a large number of small retailers serviced by multiple layers of wholesalers laid the foundation

both for the United States' demands that Japan revise the statute and the expectations that grew out of its revision, as we will see in Chapter 3.

3 Japan's distribution system: From outdated to modern?

3.1 The postwar distribution system as barrier to trade

When Japan surrendered on August 15, 1945, the Japanese economy was near collapse. Industrial output was at 10% of the prewar level, and the country faced a serious food shortage (see Hanneman, 2001: 84). Japan was forced to ultimately accept foreign occupation by the Allied Powers. The occupation lasted over six years, a period of more than double the originally envisaged three-year duration. The Allied Occupation, formally under the direction of the 11-nation Far Eastern Commission, was in fact almost totally in American hands. General Douglas MacArthur, the Supreme Commander of the Allied Powers (SCAP), had broad authority in directing its course. The United States believed that despotic rulers were imposing a culture of militarism on Japan and that no free people would of their own accord choose the course of military aggression. Thus, they believed that the surest path to demilitarization was through democratization.

The main goal of the occupation's reforms was to foster democracy by redistributing wealth. The reforms included several elements. The first task was to demilitarize the country and dismantle the Japanese war machine. Then, the new constitution was positioned as the cornerstone of political reforms and democratization. It provided the legal setting for social reforms that would foster the democratization of Japanese society. The complete revision of the civil code, however, was the central element of these social reforms. Last but not least, economic reforms were seen as crucial to bringing democracy to Japan.

At the center of the economic program was land reform. Rural poverty had been a serious problem during the prewar period, when plans for land reforms had existed but were never implemented. Certain landowners, such as absentee landlords, owner-operators cultivating more than the maximum amount of land permitted, and lessors that were either owner-operators or resident landlords holding more land than was allowed, were forced to sell land to the government, which then resold the land to new farmers. Between 1946 and 1949, approximately three million households bought land

from the government (see Campbell, 1952: 362).

The second element of the economic reforms was the break-up of the *zaibatsu*. *Zaibatsu* were large financial concerns that were believed to have fueled Japanese military aggression. The Anti-Monopoly Law of 1947 outlawed *zaibatsu* companies and required 325 companies to be split into their constituent companies and *zaibatsu* stock to be sold to the public (see Hanneman, 2001: 94).

The third pillar of the economic reforms focused on the industrial labor force. In 1947, the Labor Standards Act was enacted, regulating working hours, guaranteeing worker compensation, establishing safety and sanitation standards, and limiting child labor. Labor unionization grew rapidly (see Hanneman, 2001: 84).

The Allied Powers had originally planned to contain Japan by allowing it to become a peaceful, relatively weak agrarian nation. The eventual success of the communist revolution in China prompted the occupation policy to take a so-called “reverse course.” After 1948, the occupation policy was revised to shift its focus to building Japan into an economic powerhouse that would serve as a bulwark against communism in East Asia (see Hanneman, 2001: 84-85).

By the 1950s, the economy had stabilized (see Cargill and Sakamoto, 2008: 4). The Korean War, which began in the early hours of June 25, 1950, when North Korean troops crossed the 38th parallel and invaded South Korea, triggered Japan’s postwar economic growth. With its untapped resources and potential workforce, Japan could easily supply the United States army with steel and the resources required to support other heavy industries – and it continued to do so even after the war ended in a stalemate in July of 1953 (see Hanneman, 2001: 96).

The Japanese economy exhibited impressive economic up-trends that shifted the country’s position as a third-world country, allowing it to rival the United States in terms of economic development. Historical data reveal that Japan’s economy exhibited growth percentages of approximately 9% a year during the 1950s, approximately 10% a year in the early 1960s, and more than 13% a year in the late 1960s and early 1970s (see Henshall, 1999: 154). With the emergence of Japan as a major power, books started to appear analyzing its route to success; one such example is Herman Kahn’s popular 1971 work “The Emerging Japanese Superstate”, which sang Japan’s praises.

The Japanese also proposed theories explaining their success and usually followed a line of argument indicating that Japan was somehow unique and special, with national characteristics such as loyalty, harmony, and group orientation. They also claimed, although with questionable evidence, that Japanese interpersonal relations were unique and stronger than in other societies (see Henshall, 1999: 161-162). Others viewed the origin of Japan's economic success as rooted in its political economy, which was characterized by interinstitutional cooperation and included a myriad of formal and informal relationships between bureaucracy, politics (i.e., the Liberal Democratic Party, LDP²²) and the private sector, also called the "Iron Triangle" (see, for example, Colignon and Usui, 2001). The Iron Triangle allegedly produced a homogenous outlook and a common orientation on the part of institutional elites based on the belief that interinstitutional cooperation produces the best outcome for all (see Colignon and Usui, 2001: 865-866). Johnson (1982) labeled Japan a "developmental state" and located the driving force behind Japan's economic development at the Ministry of International Trade and Industry (MITI), which dominated the economy and actively and successfully directed its course.

By 1973, Japan was the third largest economy in the world, ranking just behind the United States and the Soviet Union.²³ The country had become the largest producer of ships, radios, and televisions. It was also the second-largest producer of cars and the third-largest producer of steel. Although Japanese exports seemed to dominate globally, the ratio of Japanese exports was below that of most nations (see, for example, Lawrence: 1987). Because the Japanese Gross National Product (GNP) had grown so substantially, exports seemed to dominate in absolute terms. The tendency to exclusively compare Japan with the United States (which had a low export-to-GNP ratio), together with the United States' massive trade imbalance with Japan, has fueled

²² In 1955, two conservative parties merged to form the LDP (Liberal Democratic Party), and the left- and right-wing socialist parties merged to become the Japan Socialist Party (JSP). The new party system built around the two parties formed the basis for the so-called 1955 system. In this system, the LDP ruled without interruption until 1993 (see Cargill and Sakamoto, 2008: 7).

²³ The 1973 oil crisis began on October 17, 1973, when the members of the Organization of Arab Petroleum Exporting Countries (OAPEC), which consisted of the Arab members of OPEC plus Egypt and Syria, announced that they would no longer export oil to nations that had supported Israel in its conflict with Syria and Egypt in the context of the ongoing Yom Kippur War. This included the United States, its allies in Western Europe, and Japan.

this misconception (see, for example, Henshall, 1999: 154-156).

The Japanese commercial sector recovered in tandem with the rebuilding of Japan's economy. Between 1954 and 1969, the number of establishments in the commercial sector increased by 30%, a percentage slightly higher than the percentage of growth of all business establishments during the period. 82% of wholesale establishments and 72% of retail establishments operating in 1968 were established after 1945; nearly half of these retail and wholesale establishments were established after 1955. The majority of these new establishments was small in size and had only limited capital (see Yoshino, 1971: 15). The labor force in the distribution sector nearly doubled. This increase was considerably greater than the 21% increase in the overall labor force. Combined sales in the wholesale and retail sectors increased by almost five times between 1960 and 1969 (see Yoshino, 1971: 10).

The entry of large-scale firms into the consumer industry was a significant factor for the rapid development of the commercial sector. Until the end of World War II, most large-scale firms were engaged in the production of strategic industrial goods. After Japan's defeat, these firms were compelled to shift to peacetime industries, and many entered the consumer market. New products were launched at a remarkable rate in the 1960s. In consumer durables, for example, virtually every product was new, including television sets, washing machines, refrigerators, air conditioning units, transistor radios, and vacuum cleaners. In the food industry, new products ranged from instant coffee, breakfast cereals, and frozen foods to ready-to-eat packaged foods. Similar patterns can be identified in automobiles, apparel, cosmetics, and pharmaceuticals.

Between 1953 and 1968, private consumption expanded by more than five times and reached over JPY 26.6 trillion in 1968. This valuation accounted for slightly more than 50% of the Gross National Product (GNP). In 1968, the growth in personal consumption expenditure alone accounted for nearly half of the 14% real growth of the Gross Domestic Product (GDP) during the preceding year. Between 1960 and 1967, incomes doubled (see Yoshino, 1971: 30-31).

Foreign companies trying to tap into Japan's growing consumer markets found that making inroads was not as easy as projected. Whereas Japan ran trade deficits with countries like Canada and Australia, from which it imported raw materials, it ran

considerable trade surpluses with both the United States and the European Union during the 1980s (see Maguire, 2000). Studies concluded that the prices of foreign-produced goods were noticeably higher in Japan than they were in other countries in the 1970s and 1980s; in addition, the prices of Japanese goods in Japan were not substantially higher than in non-domestic markets at that time. This adverse effect was taken as empirical and conclusive evidence that the Japanese market was relatively closed and that competition was restricted. Knetter (1994), for example, examined the behavior of foreign firms exporting both to Japan and other destinations and tested country-specific differences in the prices charged by exporters to buyers in different destinations. He found that the data for 37 German export industries clearly showed that for the vast majority of industries examined, the prices of German exports to Japan were systematically higher than the prices of German exports to the United States, the U.K., and Canada. Because neither the effect of differences in the composition of export unit values nor the possibility of non-linear pricing (potentially leading to lower average prices for higher-volume importers) could explain his findings, he concluded that higher relative non-tariff barriers in Japan contributed to higher relative retail prices (see Knetter, 1994: 16). A joint survey of the prices of goods in Japan and the United States in 1991, conducted by the Japanese Ministry of International Trade and Industry (MITI) and the United States Department of Commerce, reported that prices for two-thirds of the 112 surveyed products were higher in Japan. On average, Japanese prices exceeded United States prices by 37%. High distribution costs due to Japan's inefficient distribution system were seen as an important cause of the relatively high final goods prices there (see Knetter, 1994: 4).

In light of this finding, both Japan and a number of foreign countries identified the need to address the restrictions on foreign products in Japan's market. To facilitate the importation of foreign products, the G5 Nations (France, West Germany, Japan, the United States, and the United Kingdom) signed an agreement called the Plaza Accord in 1985 that would devalue the U.S. dollar in relation to the Japanese yen and German Deutsche Mark by intervening in currency markets. Devaluing the dollar would make the United States' exports cheaper for its trading partners, which in turn meant that other countries would buy more American-made goods and services. In addition, a stronger yen would lead foreigners to establish distribution networks in Japan and alter

distribution structures (see Lawrence, 1987: 547).

The United States trade deficit with Western European nations decreased. However, the primary objective of reducing the trade deficit with Japan was not achieved. Even though Japanese imports of manufactured goods were found to be fairly responsive to relative price changes, devaluing the dollar did not result in significant inroads for American products and services (see Lawrence and Krugman, 1987: 547).

Thus, it was concluded that the low level of manufactured imports must have been due to impediments such as buyer preferences and a lack of competitiveness in the distribution system. The latter was identified as a key factor in the apparent failure of foreign firms to establish major market participation in Japan and portrayed as an almost insurmountable barrier to firms from outside Japan. Both Japanese and foreign observers viewed Japanese distribution, particularly for physical consumer goods, as outdated, inefficient, unnecessarily complex and a drag on competition (see, for example, Riethmuller, 1994: 517; Dewey Ballantine LLP and Cyberworks Japan, 2001: 15).

In the final report of the Structural Impediments Initiative (SII) talks, which were held to identify specific areas impeding the adjustment of the trade imbalance between the United States and Japan, five consensual measures were listed for Japan that were intended to help make its market more accessible to its foreign counterparts and especially to American products and services. These measures included the improvement of import-related infrastructure, the acceleration of import clearance procedures, the continuous expansion of imports and the relaxation of distribution-related regulations (see Kikkawa and Takaoka, 1998: 101). In 1991, Japan revised the Large-Scale Retail Stores Law in response to the SII talks.

The Large-Scale Retail Stores Law and its history are outlined in the next chapter.

3.2 The Large-Scale Retail Stores Law

The history of regulations limiting the size of retail shops in Japan dates back to 1937, when the first Department Store Law was enacted. The law was a reaction to complaints from small shop owners, who constituted a strong pressure group and feared the expansion of large department stores. The law was abolished in 1947 under foreign

occupation. It was re-enacted under the same name in 1956 and was legislated to legalize a special procedure by which one could obtain a license to expand an existing retail business and/or open new stores with an area larger than 1'500 m² (see Guner, Ventura, and Yi, 2006: 304-305). The law, however, did not prevent the opening of large stores. First, the law only applied to department stores and did not cover other types of retail companies such as supermarkets, which were introduced to Japan after World War II and expanded rapidly from the 1950s onwards. Secondly, the legislation focused on retail *businesses*, meaning *individual entities*. This opened up a loophole because large department stores could be divided into several *separate business entities* (with each individual business entity not exceeding 1'500 m²) within the same building (see Guner, Ventura, and Yi, 2006: 304-305).

Complaints by small retailers led to a major revision of the law in 1974. The new law, called the Large-Scale Retail Stores Law (*daitenhō*), focused on retail stores rather than businesses and included retail formats other than the department store model. Formulated based on a French law and an adaptation of the Department Store Law of 1956, the new law restricted the growth of large stores such as supermarkets. It protected family-operated mom-and-pop stores and existing large stores from new competitors (see Riethmuller, 1994). Large stores were now required to follow a specified application process if they exceeded 1'500 m², except in large cities, where stores with an area of up to 3'000 m² were exempt from this special process (see Guner, Ventura, and Yi, 2006: 305).

In 1979, the law was reformed again. Two types of stores were now subject to restrictions.

- **Stores larger than 1'500 m² (3'000 m² in large cities) (Type-1 stores):** Applications to open this type of store had to be made to the Ministry of Trade and Industry (MITI).
- **Stores between 500 and 1'500 m² (Type-2 stores):** For these stores, applications were accepted at the prefectural (that is, local) level (see Guner, Ventura, and Yi, 2006: 305). Firms or individuals planning to open a store with an area larger than the stipulated area were required to obtain the approval of several regulatory committees (see Lothia and Subramaniam, 2000). In addition to prefectural officials,

consumers, and academics, the committees also included retailers that would face competition from the planned stores. The application process was very slow. Obtaining approval could sometimes take up to ten years, assuming an application was approved at all (see Tsuchiya and Riethmuller, 1997).

The law was altered again only three years later in 1982. These changes affected Type-1 stores. The local government now had the authority to ban the opening of new stores in certain regions. In addition, a new stage of the application process was created that required a consensus among all parties involved, including those potentially affected by the opening of the large stores (see Guner, Ventura, and Yi, 2006: 305).

In 1991, the Large-Scale Retail Stores Law was significantly relaxed in favor of large retailers. Formal and informal rules were changed. The revised law took effect in January 1992. Procedures were simplified, and the maximum process duration was set at one year. By May 1994, new stores with floor space between 500 m² to 1'000 m² were no longer subject to the regulation. Store closing times were extended to 8 p.m., and the number of regulated holidays was decreased to 24 days a year (see Guner, Ventura, and Yi, 2006: 305). According to Tsuruta and Yahagi (2002: 142), the revision of the statute limited the regulatory parameters of the system and increased its transparency. The revision also raised expectations regarding an imminent revolution in the Japanese distribution system that it was believed would be triggered by a sharp increase in the number of large stores once the revised statute was enacted (see Stern and Weitz, 1997). It was also further anticipated that the increase in the number of large stores would unleash the power of a number of technological and socio-economic developments, further accelerating change. These developments, which we call associated changes, are outlined below.

3.3 Associated changes

3.3.1 Distributional IT

Two innovations in distributional IT were expected to significantly change the distribution of power in the Japanese distribution system by reducing retailer dependence on both wholesalers and manufacturers. These innovations were the

introduction of point-of-sale (POS) systems and the increasing use of the Internet for business transactions.

POS systems gather sales-related information. The information is automatically acquired as a consumer's purchases are scanned at the register. POS systems track which products are bought at what prices and when and where the transactions take place. POS data can be used to tailor offerings and merchandise to match demand, plan sales campaigns, and improve pricing or product development. The possession of such information is regarded as conferring expert power to retailers. Retailers can use such information to decide which brands to stock and to develop and market their own brands, thereby increasing their power vis-à-vis upstream suppliers (see Stern, El-Ansary, and Coughlan, 1996: 424). Many experts agree that retailers that control POS data are better equipped to coordinate channel-wide decisions regarding inventory, delivery schedules, the nature of product assortments and product specifications (see Fahy and Taguchi, 1995; Larke, 1994; Ailawadi, Borin, and Farris, 1995; Lohtia and Subramaniam, 2000; Messinger and Narasimhan, 1995). Goldman (1991: 173) writes that large retailers in Japan that have implemented POS-based assortment monitoring systems have been giving up the privilege of returning unsold goods, thereby decreasing their dependence on manufacturers. They no longer need wholesalers and manufacturers for product assortment and merchandising. In addition, in developing their own private brands, they become serious competitors for manufacturers of branded products.

The use of the Internet for business transactions led to even more enthusiastic predictions.

"If the Internet is about anything, it is about disintermediation – or cutting out the middleman. And if Japan is about anything, it is a nation of middlemen. For scores of Japanese middlemen, then, the rise of the Internet industry threatens the end of an era. The Internet, and particularly business to business (B2B) e-commerce, looks set to rid the country of swathes of inefficient distributors, disrupting long-established supply chains and lowering distribution costs." (Nusbaum, 2000)

The use of the Internet for business transactions was predicted to make wholesalers

redundant, lower the price of products for end-consumers, and ultimately put an end to the Japanese distribution system:

“If there is one thing the Internet does in Japan – and it may be the only thing it does – it will finally destroy the Byzantine Japanese distribution system.”
(Financial Times, 2000)

Thus, a direct Internet link through which retailers could place their orders with manufacturers based on their analysis of POS data would make wholesalers redundant.

3.3.2 Private label products

Japanese consumers crave brand-name products and are willing to pay a premium for them. According to Martin and Herbig (2002: 175-176), older Japanese individuals rely on branded products because they feel secure when buying them. This emotional response is perceived to have its origins in World War II and the postwar period of poverty, when goods were scarce. Younger Japanese individuals prefer brand names because they are fashion conscious. They locate group identity and economic pride in brand names. Individuals tend to buy foreign imports only if the price differential is high or if the imported item is considered to be of higher quality or higher status (see Rajaratnam and McKinney, 1995).

Increased consumer sophistication, however, has led Japanese consumers to demand products that are high in quality but low in price (see Lothia, Xie, and Subramaniam, 2004). Retailers have reacted to this trend by developing private brand products. They have increased the number of private brands that they market at the expense of national brands (see Tsuchiya, 1997), and they import foreign-branded products at discount prices.

Furthermore, while private brands were once the domain of large-scale retailers, smaller chain stores have started developing their own private brands as well. Even though brand names remain important, price consciousness among Japanese consumers has increased (see Lothia, Xie, and Subramaniam, 2004).

3.3.3 Increase in car ownership

In the 1960s, shopping for convenience goods was performed on foot within a 300-meter radius of one's dwelling (see Yoshino, 1971: 23). Shopping by car was the exception, in part because the number of private cars per person in Japan was lower than in other nations. During the 1970s, the growth in the number of passenger cars per person in Japan averaged 9% per year (see Lothia and Subramaniam, 2000). Growth rates were 16.2% between 1980 and 1985, 23.1% between 1985 and 1990, and 18.8% between 1990 and 1995. After 1995, the growth rate slowed to 7.2% (for the period between 1995 and 2000). Between 2000 and 2004, the figure was a mere 0.3%. Nevertheless, between 1980 and 2004, the number of passenger cars for private use almost doubled (see Table 2).

Table 2: Total passenger cars for private use in Japan, 1980-2004

Year	Total passenger cars for private use (in 1'000s)	Population (in 1'000s)	Passenger cars for private use per person	Growth in %
1980	21'293	117'060	0.182	-
1985	25'595	121'049	0.211	16.2
1990	32'177	123'611	0.260	23.1
1995	38'846	125'570	0.309	18.8
2000	42'108	126'926	0.332	7.2
2004	42'506	127'687	0.333	0.3

Source: Statistical Yearbook of Japan, 2006.

It was predicted that with the increase in the number of private passenger cars per person, cars would be used more frequently for shopping trips outside one's local neighborhood. As more households came to rely on cars, small stores might lose much of their inherent advantage over large stores.

3.3.4 Larger dwellings

Japanese homes, especially in urban areas, are legendary for their small size:

“For many observers, particularly those whose attention turned to Japan in the heady 1980’s, the ‘Rich Japan, Poor Japanese’ dichotomy was epitomized by the fact that many employees of Japan’s world-beating corporations returned home to small, cramped, and far-flung quarters in neighborhoods blessed with neither sewer systems nor sidewalks.” (Eggers, 2006: 1)

Sir Roy Denman, the general director of external relations of the EC Commission in 1979, reportedly referred to the Japanese as “workaholics living in rabbit hutches” (see Eggers, 2006: 1). However, the housing situation improved, and Japanese homes became larger. Between 1988 and 2003, average dwelling space increased by 6.2% (see Table 3).

Table 3: Increase in the size of dwellings, 1988-2003

Year	Total number of dwellings (in 1'000s)	Dwelling rooms per dwelling	Area of floor space per dwelling (m ²)	Increase in %	Increase in % 1988-2003
1988	37'413	4.86	89.29	-	
1993	40'773	4.85	91.92	2.9	
1998	43'922	4.79	92.43	0.6	
2003	46'863	4.77	94.85	2.6	6.2

Source: Statistical Yearbook of Japan 2006.

In addition, the size of the average Japanese household shrank. From the 1920s to the mid-1950s, the average Japanese household had about five members. By 1970, the average number of people per household decreased to 3.41, reflecting the progressive decline in the birth rate through the 1960s. The size of the average household continued to shrink thereafter, consistent with the increase in nuclear family units of the 1970s. In the 1980s, the average number of members per household continued to decline, while the number of one-person households grew steadily. By 2000, the average household

had shrunk to 2.67 members. Of 46.78 million households, private households consisting of one or two persons accounted for 52.7%.²⁴

Larger dwellings accommodating fewer people usually offer more storage space. Therefore, households are able to maintain a larger stock and need to shop less frequently for daily necessities. This has further eroded the value of close neighborhood shops to Japanese consumers and increased the attractiveness of large stores.

3.4 Summary

The revision of the Large-Scale Retail Stores Law and the associated changes were expected to substantially increase the number and channel power of large stores.

- The revision of the Large-Scale Retail Stores Law was expected to increase the number of large retailers. The number of small retailers would decline as they faced competition from large stores and the loss of regulatory protection.
- Distributional IT was expected to provide large retailers with access to POS sales data and independence from wholesalers for product merchandising and procurement.
- Changes in shopping habits were expected to increase the attractiveness of large stores to Japanese consumers, thereby increasing the channel power of large retailers. Due to an increase in dwelling size and private car ownership rates, Japanese consumers would buy less frequently and in larger quantities because they could store more goods at home. In addition, increased consumer sophistication led consumers to demand products that are high in quality but low in price. Retailers reacted to this demand by developing private brand products, thereby reducing their dependence on manufacturers.

Changes in retail structure and channel power were expected to trigger the following

²⁴ See the Statistics Bureau of Japan. According to current projections, this average is expected to keep declining in the years ahead, reaching 2.37 in 2025. With the size of the average household shrinking further, the number of households is expected to continue to increase even after the Japanese population starts to decline. The number of households is projected to peak in 2015 and decrease thereafter.

developments:

- **Shorter distribution channels:** With the number of large retailers increasing, trade flows between manufacturers and retailers were expected to increasingly involve one level of wholesalers only. Wholesale circuitry was predicted to improve.
- **More direct sourcing:** Direct sourcing between manufacturers and retailers was expected to increase due to retailers' channel power. Large retailers would force manufacturers to supply them directly. In addition, large retailers would no longer depend on wholesalers as order placing and processing nodes due to the implementation of inter-firm EDI (electronic data interchange) systems linking manufacturers and retailers and POS (point of sales) systems enabling retailers to make the right sourcing decision based on the analysis of sales-related information gathered by POS systems.
- **Fewer wholesale establishments:** The number of wholesale establishments was expected to decline as a result of the decline in the number of small retailers, the shorter distribution channels, and the more direct sourcing patterns.

In the next chapter, we will quantitatively assess the impact of the revised statute and the associated changes in the Japanese distribution system.

4 THE IMPACT OF THE REVISED LARGE RETAIL-STORES LAW ON THE JAPANESE DISTRIBUTION SYSTEM

4.1 METHODOLOGY

This study uses quantitative and descriptive data that were collected and analyzed for the sole purpose of reassessing the research hypothesis and the expected developments of the study as outlined above.

- **The population of large-scale stores.** The study uses raw empirical data on the number of large-scale retail stores in Japan from 1960 to 2004 from the database of the Statistics Bureau of the Ministry of Internal Affairs and Communications. We initially defined a large-scale store as one with fifty employees or more, employing a workforce perspective to distinguish such enterprises from their smaller counterparts. However, other characteristics, such as annual retail sales and floor space, were also taken into account. Moreover, we conducted a comparative analysis of the large-scale stores based on workforce population, annual retail sales, and floor space. As a result, we decided to use these factors to indicate the number “large-scale” stores. However, the sample does not allow us to investigate stores that shift from “small-scale” to “large-scale” or vice versa. We also decided to retrieve quantitative data pertaining to the number of retail establishments with sales floor space of 500 m² or more from 1982 to 2004 from the Ministry of Economy, Trade and Industry (METI). To address the change in the number of stores with sales floor space of 3’000 m² or more, we determined the number of applications to open new large-scale stores filed from 1974 to 1996.
- **The population of small-scale stores.** This study collected empirical data on the number of small retail establishments from 1962 to 2004 from the Statistics Bureau of the Ministry of Internal Affairs and Communications. Before the data collection process began, we initially defined a “small-scale store” as a store with one or two employees.
- **Wholesale establishments.** This study obtained data on the number of wholesalers

from 1960 to 2004 from the Statistics Bureau of the Ministry of Internal Affairs and Communications. The study aimed to observe the effects of the statute in question on the wholesale industry. In collecting the data, we isolated wholesalers that were directly trading to retailers and final wholesalers that sourced from wholesalers and sold to retailers. In addition, we obtained supporting data that may explain developments with respect to the categories of wholesalers studied.

- **Wholesale circuitry.** This study used figures calculated by Nishimura (1993), the METI (2005), and Maruyama (2004) to indicate the length of the pre-implementation and post-implementation periods of the statute. The *w/W ratio* as used by Nishimura (1993) to indicate wholesaler circuitry is calculated as follows:

$w/W \text{ ratio} = \mu = (\text{sales from wholesalers to other wholesalers}) / (\text{total wholesale sales})$

Note that μ indicates the existence of multiple stages (i.e., more than two stages) and that S represents the number of wholesaler stages.

- If $S=1$, $\mu=0/1=0.00$ in the M-W1-N structure.
- If $S=2$, $\mu=1/2=0.50$ in the M-W1-W2-N structure.
- If $S=3$, $\mu=2/3=0.66$ in the M-W1-W2-W3-N structure.
- If $S=4$, $\mu=3/4=0.75$ in the M-W1-W2-W3-W4-N structure.

Another helpful formula that we used was introduced by Maruyama (2004) as the *wholesaler use ratio (W / U ratio)*:

$W/U \text{ ratio} = (\text{retail direct wholesalers sales}) + (\text{source wholesalers sales}) / \text{total retail sales}$

One adequate proxy for this ratio is the natural logarithm of the total mark-up divided by the natural logarithm of the average mark-up, as introduced by Nariu and Flath (1993):

$$NS = [\ln (P_n/P_o)] / [\ln (P_j/P_{j-1})]$$

Although the final quantitative data has its shortcomings, the wholesale/retail sales ratio is often used to note trends in the circuitous structure of the wholesale sector.

- **Direct Sourcing.** This study explores the relationship between retailers and manufacturers with regard to direct sourcing. Although the data and studies on direct sourcing are limited, we intend to find supporting data to either disprove or prove that this type of development has occurred in response to the implementation of the statute in subject.

4.2 DATA ANALYSIS

In this chapter, we look for quantitative evidence of the following expected developments.

- An increase in the number of large stores.
- A decrease in the number of small traditional retailers.
- A decrease in the number of wholesalers.
- Improved wholesale circuitry.
- More direct sourcing between retailers and manufacturers.

4.2.1 An increase in the number of large stores

The average sales floor area for all retail establishments increased continuously between 1960 and 2004 (see Table 4). In 1999, the average Japanese retail establishment (including all stores) had a sales floor space of about 95.2 m². As compared to the average sales floor space of 69.1 m² in 1991, this corresponds to growth of almost 38%. By 2004, the average sales floor space for Japanese retail establishments had grown further to 116.4 m². As compared to the average of 24.1 m² in 1960, this increase represented a near-fivefold gain. Although the annual growth rates exhibit significant differences, the largest amount of positive growth was recorded in 1994, when the average sales space increased by over 17% as compared to the previous figure for 1991.

Table 4: Average sales floor space (m²) per retail establishment, 1952-2004

Year	Total number of establishments	Sales floor space (m ²)	Average sales floor space (m ²) per establishment	Growth in % (compared to the previous year)
1952	1'079'728	n.a.	n.a.	n.a.
1954	1'189'045	n.a.	n.a.	n.a.
1956	1'201'273	n.a.	n.a.	n.a.
1958	1'244'629	n.a.	n.a.	n.a.
1960	1'288'292	31'081'224	24.1	n.a.
1962	1'271'975	33'005'295	25.9	7.6
1964	1'304'536	39'081'705	30.0	15.5
1966	1'375'394	44'840'620	32.6	8.8
1968	1'432'436	47'583'151	33.2	1.9
1970	1'471'297	54'723'980	37.2	12.0
1972	1'495'510	61'108'675	40.9	9.9
1974	1'548'184	67'405'931	43.5	6.6
1976	1'614'067	74'973'890	46.5	6.7
1979	1'673'667	85'736'815	51.2	10.3
1982	1'721'465	95'430'071	55.4	8.2
1985	1'628'644	94'506'983	58.0	4.7
1988	1'619'752	102'050'766	63.0	8.6
1991	1'591'223	109'901'497	69.1	9.6
1994	1'499'948	121'623'712	81.1	17.4
1997	1'419'696	128'083'639	90.2	11.3
1999	1'406'884	133'869'296	95.2	5.5
2002	1'300'057	140'619'288	108.2	13.7
2004	1'238'296	144'190'054	116.4	7.7

Source: Based on Statistics Bureau, Ministry of Internal Affairs and Communications; Historical Statistics of Japan, Chapter 13, Domestic Trade.

Analyzing large stores alone, the Statistics Bureau of Japan provides metrics for retail outlets that are classified as large-scale stores. The term “large-scale store” refers to locations with 50 employees or more. In addition to indicating the number of employees, the data include information about the sales floor area, annual revenues, and the value of the commodity stocks of large-scale retail stores from 1972 to 2002 (see Table 5). According to this data,

- The number of stores with 50 or more employees increased constantly both between 1992 and 2000 and between 1972 and 2002, although there was a very small decline in 1988-1989. Between 1992 and 2000, the largest increases took place between 1993 and 1994 (9%) and between 1997 and 1998 (8%). On average, the number of large stores increased by 5% between 1992 and 2000. Interestingly, the largest increases between 1972 and 2002 did not take place after the revision of the Large-Scale Retail Stores Law but instead were recorded in 1973 (18%) and 1977 (11%).
- The number of people employed in retail establishments with 50 or more employees increased constantly between 1992 and 2000 and between 1972 and 2002, although there was a very minimal decline in 2001. The largest increase (16%) took place in 1973. Growth rates after 1992 were slightly higher than the pre-1992 numbers but were still moderate. The discrepancies between the growth rates in terms of the number of stores and the number of employees may be due to the greater productivity of larger stores as compared to traditional mom-and-pop stores.
- The total sales floor space for retail establishments with 50 or more employees steadily increased between 1992 and 2000 and between 1978 (the first year for which data are available) and 2001. The first negative growth rate of -2% appeared in 2002. Substantial growth occurred in 1981 (9%) and between 1994 and 1998, during which growth was 6% or more annually.
- The total value of annual sales at retail establishments with 50 or employees exhibited the greatest amount of growth for 1979 (8%), 1980 (11%), 1981 (8%), 1988 (7%), 1989 (8%), and 1990 (8%). Growth rates were slightly negative from 1998 to 2002, as is consistent with the overall trend of declining retail sales during that period. However, the decline in sales by retail establishments with 50 or more employees was less dramatic than the overall trend (see Table 6).

Table 5: Number of large stores, number of employees, sales floor area, and value of annual sales, 1972-2002

Year	Number of stores*	Change in %	Number of employees*	Change in %	Sales floor space* (1'000 m ²)	Change in %	Value of annual sales **	Change in %
1972	1'099	-	238'256	-	-	-	4'094'391	-
1973	1'295	18%	276'275	16%	-	-	5'355'049	-
1974	1'394	8%	296'446	7%	-	-	6'652'145	-
1975	1'463	5%	291'788	-2%	-	-	7'566'387	-
1976	1'524	4%	310'095	6%	-	-	8'396'922	-
1977	1'694	11%	325'621	5%	-	-	9'310'669	-
1978	1'764	4%	338'105	4%	11'484	-	10'230'283	-
1979	1'824	3%	347'374	3%	11'849	3%	11'019'794	8%
1980	1'938	6%	362'545	4%	12'592	6%	12'185'251	11%
1981	2'071	7%	377'573	4%	13'685	9%	13'163'727	8%
1982	2'175	5%	387'114	3%	14'147	3%	13'733'834	4%
1983	2'235	3%	391'379	1%	14'639	3%	14'146'265	3%
1984	2'273	2%	391'338	0%	14'851	1%	14'743'909	4%
1985	2'291	1%	390'767	0%	15'164	2%	15'281'467	4%
1986	2'331	2%	398	2%	15'585	3%	15'977	5%
1987	2'343	1%	402	1%	15'928	2%	16'754	5%
1988	2'346	0%	411	2%	16'258	2%	17'884	7%
1989	2'341	0%	422	3%	16'820	3%	19'376	8%
1990	2'358	1%	424	0%	17'343	3%	20'942	8%
1991	2'429	3%	444	5%	17'739	2%	22'164	6%
1992	2'451	1%	463	4%	18'269	3%	22'204	0%
1993	2'486	1%	468	1%	19'008	4%	21'490	-3%
1994	2'720	9%	485	4%	20'442	8%	21'793	1%
1995	2'871	6%	489	1%	21'591	6%	22'340	3%
1996	3'000	4%	509	4%	22'942	6%	22'976	3%
1997	3'185	6%	536	5%	24'450	7%	23'413	2%
1998	3'439	8%	552	3%	25'851	6%	23'248	-1%
1999	3'644	6%	562	2%	27'209	5%	23'124	-1%
2000	3'792	4%	581	3%	28'686	5%	22'634	-2%
2001	3'898	3%	579	0%	28'974	1%	22'341	-1%
2002	4'013	3%	597	3%	28'488	-2%	22'033	-1%

Value in billions of yen. Until 1985, in millions of yen. Number of stores and persons engaged in thousands. Until 1985, in persons. *At the end of the year. **Beginning 1990, including consumption tax.

Source: Based on Statistics Bureau, Ministry of Internal Affairs and Communications; Historical Statistics of Japan, Chapter 13, Domestic Trade.

Table 6: Annual sales in the Japanese retail industry, 1952-2004

Year	Total number of retail stores	Annual sales of goods (in millions of yen)	Growth in %
1952	1'079'728
1954	1'189'045
1956	1'201'273
1958	1'244'629	3'548'626	...
1960	1'288'292	4'315'387	22%
1962	1'271'975	6'148'961	42%
1964	1'304'536	8'349'588	36%
1966	1'375'394	10'683'623	28%
1968	1'432'436	16'507'256	55%
1970	1'471'297	21'773'438	32%
1972	1'495'510	28'292'696	30%
1974	1'548'184	40'299'895	42%
1976	1'614'067	56'029'077	39%
1979	1'673'667	73'564'400	31%
1982	1'721'465	93'971'191	28%
1985	1'628'644	101'718'812	8%
1988	1'619'752	114'839'927	13%
1991	1'591'223	140'638'104	22%
1994	1'499'948	143'325'065	2%
1997	1'419'696	147'743'116	3%
1999	1'406'884	143'832'551	-3%
2002	1'300'057	135'109'295	-6%
2004	1'238'296	133'278'631	-1%

Source: Based on data from the Statistics Bureau, Ministry of Internal Affairs and Communications; Historical Statistics of Japan, Chapter 13, Domestic Trade.

The Ministry of Economy, Trade and Industry (METI) provides data on retail establishments with sales floor areas of 500 m² or greater for an extended period (see Table 7). The data exhibit the following trends: the total number of retail establishments with sales floor area of 500 m² or more constantly increased between 1991 and 1999 and between 1982 and 2004. The largest growth rate (24%) was recorded between 1994 and 1997; between 1991 and 1994, the growth rate was 14%, while the growth rate was 10% between 1985 and 1988.

For retail establishments with sales floor area of 3'000 m² or more that therefore fell into either the Type-1 or the Type-2 category according to the revised Large-Scale Retail Stores Law, the following developments took place between 1994 and 2004:

- Retail establishments with sales floor area of between 3'000 m² and 6'000 m² (Type-1 stores) exhibited the largest increase (42%) between 1994 and 1997. During the same period, Type-2 stores (6'000 m² or larger) also showed two-digit area growth rates: 15% for retail establishments with sales floor area of 6'000 m² to 10'000 m² and 26% for both retail establishments with sales floor area of 10'000 m² to 20'000 m² and retail establishments with sales floor area of over 20'000 m².
- Between 1997 and 1999, retail establishments with sales floor area of more than 20'000 m² reported the largest growth rates (26%). Retail establishments with sales floor area of more than 3'000 m² also exhibited double-digit or close to double-digit growth rates. Retail establishments with sales floor area of 3'000 m² to 6'000 m² exhibited a growth rate of 14%, retail establishments with sales floor area of 6'000 m² to 10'000 m² exhibited a growth rate of 9%, and retail establishments with sales floor space of 10'000 m² to 20'000 m² recorded a growth rate of 14%.
- Between 1999 and 2004, the number of retail establishments with sales floor area between 1'500 m² and less than 3'000 m² increased by 36%, while the number of retail establishments with sales floor space of 6'000 m² or more decreased by 22%.²⁵

²⁵ This decrease may be attributed to the retreat of foreign retailers that had opened large stores in suburban areas that ultimately proved unprofitable (see, for example, Sato, 2004b). One example is Carrefour, a French retailer that opened an outlet in December 2000 in the Makuhari district of Chiba, northeast of Tokyo. In the same month, Costco, a United States wholesaler, opened a store just a kilometer away.

Table 7: Number of stores with sales floor space of 500 m² or more

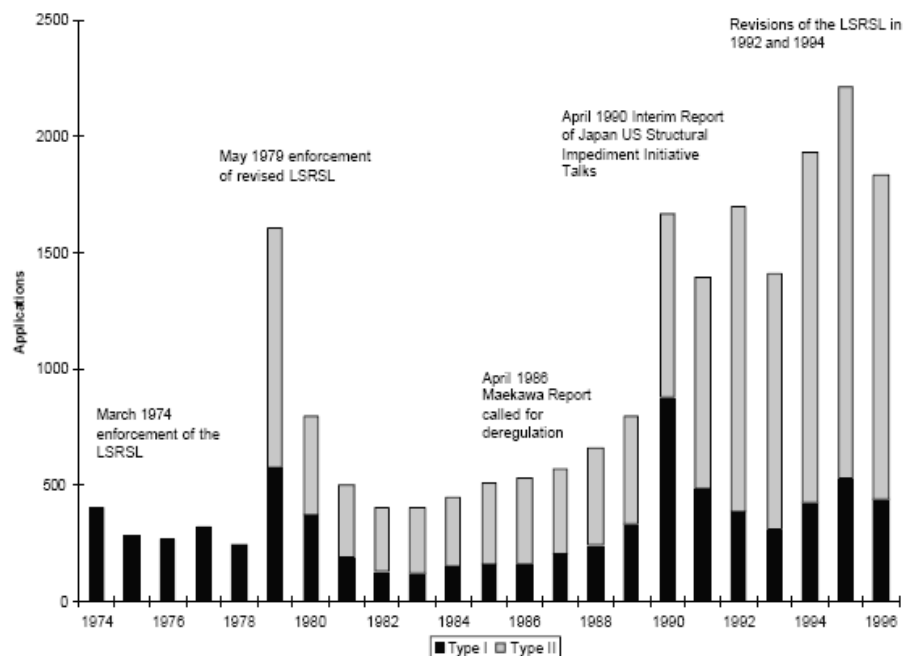
	1982	Change in %	1985	Change in %	1988	Change in %	1991	Change in %	1994	Change in %	1997	Change in %	1999	Change in %	2004	Change in %
Total stores	13'124	-	13'286	1%	14'632	10%	15'511	6%	17'643	14%	21'892	24%	23'897	9%	24'329	2%
500 m ² - 1'000 m ²	-	-	-	-	-	-	-	-	5'817	-	7'836	35%	8'671	11%	24'329	181%
1'000 m ² - 1'500 m ²	-	-	-	-	-	-	-	-	5'296	-	5'366	1%	5'249	-2%	5'992	14%
1'500 m ² - 3'000 m ²	-	-	-	-	-	-	-	-	2'908	-	3'984	37%	4'627	16%	6'294	36%
3'000 m ² - 6'000 m ²	-	-	-	-	-	-	-	-	1'593	-	2'255	42%	2'574	14%	2'819	10%
6'000 m ² - 10'000 m ²	-	-	-	-	-	-	-	-	977	-	1'128	15%	1'226	9%		
10'000 m ² - 20'000 m ²	-	-	-	-	-	-	-	-	773	-	972	26%	1'106	14%	2'154	-22%
Over 20'000 m ²	-	-	-	-	-	-	-	-	279	-	351	26%	444	26%		

*All stores over
6'000 m²

Source: Based on various statistics from the METI.

The increase in the number of retail establishments with sales floor area greater than 3'000 m², all of which fell under the Large-Scale Retail Law even after its revision in the early 1990s, is also indicated by the number of applications to open large stores. Graph 4 shows the number of applications to open new stores lodged with the MITI.

Graph 4: Applications to open new large-scale retail stores, 1974-1996



Source: Riethmuller and Chai, 1999: 4.

Overall, the number of large stores increased after the revision of the Large-Scale Retail Stores Law. However, two questions remain unanswered regarding changes in the number of large stores during the period following the revision of the Large-Scale Retail Stores Law.

- There seems to be a correlation between the revision of the Large-Scale Retail Stores Law and the number of large retail stores, but is the revision of the Large-Scale Retail Stores Law specifically a driver of the increase in the number of large retail stores?
- How does the rate of change or the increase in the number of large stores compare with that in other countries?

Regarding the first question, Riethmuller and Chai (1999) have concluded that the change to the revised statute probably did make a difference in the number of applications to open new stores. However, they point out that the late 1980s and the early part of the 1990s were the years of the bubble economy and that retailers' expectation that the boom would last forever led, at least partly, to the large number of applications (see Riethmuller and Chai, 1999: 3).

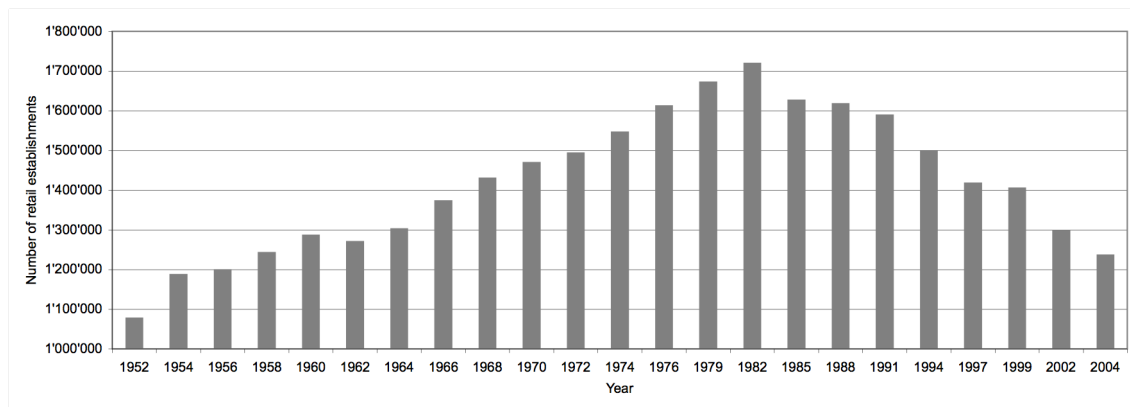
In considering the second question, Davies and Itoh (2001: 93) have assessed the change in the Japanese retail market as being relatively small and slow compared to reasonable expectations. They compare Japan to the United Kingdom, using the rationale that the United Kingdom is at roughly the same latitude as Japan and that the two countries share the same climate and have similar population densities and car ownership rates. Although they reject the null hypotheses that no change in structure occurred when the Large-Scale Retail Stores Law was liberalized, they stress that correlation is no guarantee of causality and that many things can affect retail structure.

4.2.2 A decrease in the number of small traditional retailers

In tandem with increased competition from larger stores, the number of small traditional retailers was expected to decline. This reasoning is based on the notion that the ubiquity of small mom-and-pop stores was related to the long history of government protection of small stores from the competition of large stores (see Flath and Nariu, 1996: 182).

According to the data, the total number of retail establishments peaked in 1982 at 1'721'465. Thereafter, it declined continuously, reaching 1'238'049 in 2004. Hence, the decline in the total number of retail establishments started at some point between 1982 and 1985 (see Graph 5).

Graph 5: Total number of retail establishments, 1952-2004



Source: Statistics Bureau, Ministry of Internal Affairs and Communications; Historical Statistics of Japan, Chapter 13, Domestic Trade; METI Census of Commerce 2004.

In analyzing the number of retail establishments in each size category (see Table 8), we find that the decline was mainly caused by almost 100'000 retail establishments with one to two employees going out of business. This is the category of retail store that was expected to be most severely affected by changes in the regulatory environment. Between 1982 and 1985, the total number of retail establishments decreased by 5.4% or 92'821 stores. During this period, 9.3% or 96'023 retail establishments with one to two employees and 1.1% or 4'523 retail establishments with three to four employees went out of business. Retail formats with more than five employees exhibited single-digit growth rates between 1982 and 1985.

After 1985, retail establishments with one to two employees showed negative growth for the period under analysis. All categories except for establishments with three to four employees or more than 100 employees exhibited double-digit growth rates in 1988 and then again in 1994 and 1999. Between 1997 and 1999, retail establishments with more than 100 employees grew by 31.3%.

These growth rates may be attributable to the revision of the Large-Scale Retail Stores Law, but the decrease in the number of small retail establishments starting in 1985 cannot be similarly linked to this legislation. Hence, it is not clear why the number of small retail establishments started to decline between 1982 and 1985.

Table 8: The number of retail establishments based on numbers of employees, 1952-2004

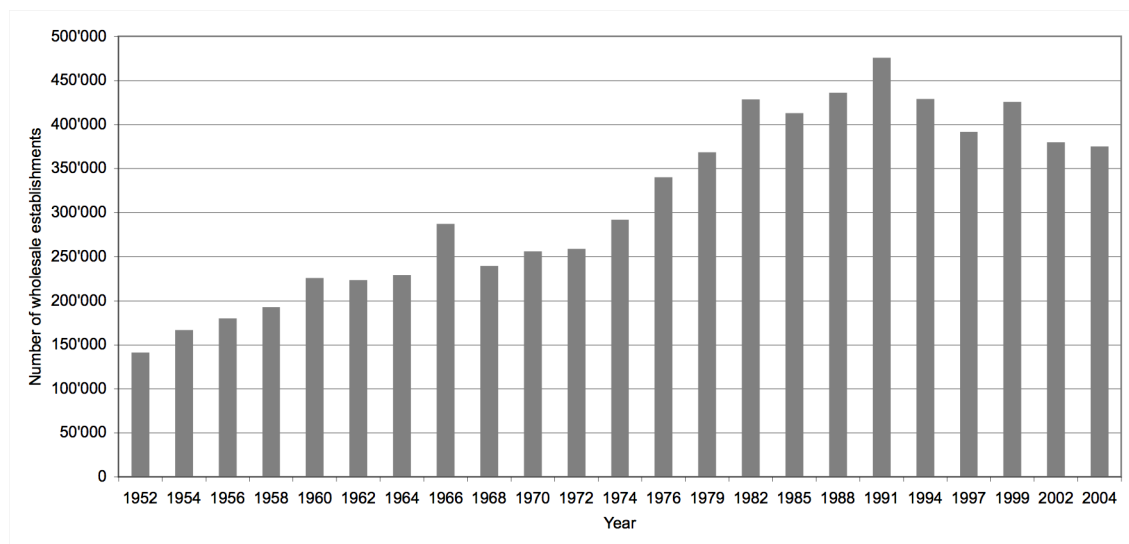
Year	Total number of retail establishments	Change in % to previous year	Number of retail establishments with															
			1-2 employees	Change in % to previous year	3-4 employees	Change in % to previous year	5-9 employees	Change in % to previous year	10-19 employees	Change in % to previous year	20-29 employees	Change in % to previous year	30-49 employees	Change in % to previous year	50-99 employees	Change in % to previous year	100 employees or more	Change in % to previous year
1952	1'079'728	-	1'029'213	-	-	-	41'077	-	7'247	-	1'222	-	559	-	410	-	-	-
1954	1'189'045	10.1%	1'113'873	8.2%	-	-	59'873	45.8%	11'599	60.1%	2'092	71.2%	992	77.5%	616	50.2%	-	-
1956	1'201'273	1.0%	862'620	-22.6%	244'545	-	77'027	28.7%	13'267	14.4%	2'173	3.9%	1'002	1.0%	639	3.7%	-	-
1958	1'244'629	3.6%	871'764	1.1%	266'347	8.9%	85'013	10.4%	15'949	20.2%	3'081	41.8%	1'531	52.8%	640	0.2%	304	-
1960	1'288'292	3.5%	914'676	4.9%	247'743	-7.0%	97'373	14.5%	20'548	28.8%	4'234	37.4%	2'326	51.9%	966	50.9%	426	40.1%
1962	1'271'975	-1.3%	907'005	-0.8%	240'154	-3.1%	91'970	-5.5%	23'039	12.1%	5'043	19.1%	2'941	26.4%	1'269	31.4%	554	30.0%
1964	1'304'536	2.6%	916'835	1.1%	250'897	4.5%	98'240	6.8%	26'318	14.2%	6'221	23.4%	3'730	26.8%	1'609	26.8%	686	23.8%
1966	1'375'394	5.4%	939'987	2.5%	280'395	11.8%	110'827	12.8%	29'867	13.5%	7'316	17.6%	4'316	15.7%	1'893	17.7%	793	15.6%
1968	1'432'436	4.1%	942'759	0.3%	305'046	8.8%	131'184	18.4%	36'560	22.4%	8'260	12.9%	5'032	16.6%	2'388	26.1%	1'207	52.2%
1970	1'471'297	2.7%	940'808	-0.2%	330'612	8.4%	141'672	8.0%	39'105	7.0%	9'223	11.7%	5'707	13.4%	2'826	18.3%	1'344	11.4%
1972	1'495'510	1.6%	927'728	-1.4%	348'919	5.5%	156'939	10.8%	41'778	6.8%	9'909	7.4%	5'980	4.8%	2'886	2.1%	1'371	2.0%
1974	1'548'184	3.5%	967'185	4.3%	360'761	3.4%	158'218	0.8%	41'311	-1.1%	10'115	2.1%	6'088	1.8%	2'962	2.6%	1'544	12.6%
1976	1'614'067	4.3%	999'622	3.4%	382'184	5.9%	165'852	4.8%	43'627	5.6%	11'113	9.9%	6'808	11.8%	3'282	10.8%	1'579	2.3%
1979	1'673'667	3.7%	1'022'103	2.2%	401'188	5.0%	175'951	6.1%	47'591	9.1%	12'943	16.5%	8'188	20.3%	4'021	22.5%	1'682	6.5%
1982	1'721'465	2.9%	1'036'046	1.4%	412'701	2.9%	187'898	6.8%	54'156	13.8%	14'776	14.2%	9'494	16.0%	4'519	12.4%	1'875	11.5%
1985	1'628'644	-5.4%	940'023	-9.3%	408'178	-1.1%	190'434	1.3%	57'911	6.9%	15'340	3.8%	10'035	5.7%	4'764	5.4%	1'959	4.5%
1988	1'620	-0.5%	874	-7.0%	422	3.4%	214	12.4%	70	20.9%	19	23.9%	12	19.6%	5.4	13.4%	2.1	7.2%
1991	1'591	-1.8%	847	-3.1%	417	-1.2%	214	0.0%	72	2.9%	20	5.3%	13	8.3%	5.9	9.3%	2.3	9.5%
1994	1'500	-5.7%	765	-9.7%	371	-11.0%	223	4.2%	90	25.0%	26	30.0%	16	23.1%	7.2	22.0%	2.9	26.1%
1997	1'420	-5.3%	709	-7.3%	350	-5.7%	212	-4.9%	93	3.3%	28	7.7%	16	0.0%	7.9	9.7%	3.2	10.3%
1999	1'407	-0.9%	685	-3.4%	317	-9.4%	227	7.1%	112	20.4%	34	21.4%	18	12.5%	9.9	25.3%	4.2	31.3%
2002	1'300	-7.6%	603	-12.0%	298	-6.0%	219	-3.5%	115	2.7%	33	-2.9%	18	0.0%	10	1.0%	4.5	7.1%
2004	1'238	-4.8%	569	-5.6%	284	-4.7%	208	-5.0%	112	-2.6%	33	0.0%	17	-5.6%	10	0.0%	4.5	0.0%

Source: Based on Historical Statistics of Japan, Chapter 13, Domestic Trade; METI, Census of Commerce.

4.2.3 A decrease in the number of wholesalers

According to data from the Japan Statistics Bureau, the total number of wholesale establishments peaked in 1991 at approximately 476'000. Except for the years 1962, 1968, and 1985, when the total number decreased by 1%, 17%, and 4%, respectively, the total number of wholesale establishments steadily increased until 1991. Between 1991 and 1994 and between 1994 and 1997, the number declined by about 9% and 10%, respectively. Between 1997 and 1999, the total number increased again by about 9% before it decreased again by almost 11% between 1999 and 2002. In the last recorded year (2004), negative growth was at 1%. Thus, there has been an overall negative trend since 1991 except for the increase of 9% between 1997 and 1999 (see Graph 6 and Table 9).

Graph 6: The total number of wholesale establishments, 1952-2004



Source: Statistics Bureau, Ministry of Internal Affairs and Communications; Historical Statistics of Japan, Chapter 13, Domestic Trade.

Table 9: The total number of wholesale establishments, 1952-2004

Year	Number of wholesale establishments	Change to previous year
1952	141'457	-
1954	166'725	18%
1956	179'856	8%
1958	192'653	7%
1960	225'993	17%
1962	223'409	-1%
1964	229'248	3%
1966	287'208	25%
1968	239'507	-17%
1970	255'974	7%
1972	259'163	1%
1974	292'155	13%
1976	340'249	16%
1979	368'608	8%
1982	428'858	16%
1985	413'016	-4%
1988	436'000	6%
1991	476'000	9%
1994	429'000	-10%
1997	392'000	-9%
1999	426'000	9%
2002	380'000	-11%
2004	375'378	-1%

Source: Historical Statistics of Japan, Chapter 13, Domestic trade; METI, Census of Commerce, 2004.

The above figures, however, include wholesalers with sales that did not go through the retail market, such as wholesalers that would sell to industrial users, export overseas, and/or execute transactions between headquarters and branch offices of the same company. The data from the Japan Statistic Bureau are not separated based on the various categories of wholesalers. The 2002 Census of Commerce published by METI, however, includes a “Report by Distribution Route” for the years 1994, 1997, and 2002 (see Table 10).

Table 10: Establishments conducting the wholesale trade of consumer goods, ordered by distribution level and distribution route

Wholesale level	Distribution route		No. of establishments			Composition			Rate of change (%)		
	Sourcing from	Selling to	1994	1997	2002	1994	1997	2002	1994 - 1997	1997 - 2002	1994 - 2002
Total wholesale sector (consumer goods)			163'275	151'288	148'270	100%	100%	100%	-7.3%	-2.0%	9.2%
1.Primary wholesale											
第一次卸			59'280	50'745	46'769	36.3%	33.5%	31.5%	-14.4%	-7.8%	-21.1%
1.1 Direct trade wholesalers											
直取引卸			40'798	34'618	29'678	25.0%	22.9%	20.0%	-15.1%	-14.3%	-27.3%
1.1.1 Direct trade wholesalers 他部門直取引（取引先が他の産業である直取引卸）			10'838	9'735	8'434	6.6%	6.4%	5.7%	-10.2%	-13.4%	-22.2%
	Sourcing from producers 生産業者から仕入れ	Selling to industrial users 生産使用者へ販売	9'996	8'944	7'503	6.1%	5.9%	5.1%	-10.5%	-16.1%	-24.9%
	Sourcing from producers 生産業者から仕入れ	Selling to overseas 国外へ販売	396	282	247	0.2%	0.2%	0.2%	-28.8%	-12.4%	-37.6%
	Sourcing from overseas 外国から仕入れ	Selling to industrial users 生産使用者へ販売	365	398	529	0.2%	0.3%	0.4%	9.0%	32.9%	44.9%
	Sourcing from overseas 外国から仕入れ	Selling overseas 国外へ販売	81	111	155	0.0%	0.1%	0.1%	37.0%	39.6%	91.4%
1.1.2 Direct trade wholesale to retailers 小売直取引（販売先が小売業者である直取引卸）			29'960	24'883	21'244	18.3%	16.4%	14.3%	-16.9%	-14.6%	-29.1%
	Sourcing from producers 生産業者から仕入れ	Selling to retailers 小売業者へ販売	28'525	23'406	19'241	17.5%	15.5%	13.0%	-17.9%	-17.8%	-32.5%
	Sourcing from overseas 外国から仕入れ	Selling to retailers 小売業者へ販売	1'435	1'477	2'030	0.9%	1.0%	1.4%	2.9%	37.4%	41.5%
1.2 Source wholesalers 元卸			18'482	16'127	17'091	11.3%	10.7%	11.5%	-12.7%	6.0%	-7.5%
	Sourcing from producers 生産業者から仕入れ	Selling to wholesalers 卸売業者へ販売	15'843	13'566	13'302	9.7%	9.0%	9.0%	-14.4%	-1.9%	-16.0%
	Sourcing from overseas 外国から仕入れ	Selling to wholesalers 卸売業者へ販売	2'639	2'561	3'789	1.6%	1.7%	2.6%	-3.0%	48.0%	43.6%
2. Secondary wholesale level											
第二次卸			68'344	68'945	71'411	41.9%	45.6%	48.2%	0.9%	3.6%	4.5%
2.1 Intermediate wholesalers 中間卸			16'211	17'918	21'579	9.9%	11.8%	14.6%	10.5%	20.4%	33.1%
	Sourcing from wholesalers 卸売業者から仕入れ	Selling to wholesalers 卸売業者へ販売	16'211	17'918	21'579	9.9%	11.8%	14.6%	10.5%	20.4%	33.1%
2.2 Final wholesalers 最終卸			52'133	51'027	49'832	31.9%	33.7%	33.6%	-2.1%	-2.3%	-4.4%
	Sourcing from wholesalers 卸売業者から仕入れ	Selling to industrial users 生産使用者へ販売	15'291	15'894	15'999	9.4%	10.5%	10.8%	3.9%	0.7%	4.6%
	Sourcing from wholesalers 卸売業者から仕入れ	Selling overseas 国外へ販売	174	163	209	0.1%	0.1%	0.1%	-6.3%	28.2%	20.1%
	Sourcing from wholesalers 卸売業者から仕入れ	Selling to retailers 小売業者へ販売	36'668	34'970	33'624	22.5%	23.1%	22.7%	-4.6%	-3.8%	-8.3%
3. Other wholesalers その他の卸			35'651	31'598	30'090	21.8%	20.9%	20.3%	-11.4%	-4.8%	-15.6%

Source: METI, 2004: 14.

The figures in Table 10 still include trade flows from wholesalers to overseas and industrial users. We therefore look only at the categories of direct trade wholesalers who serve retailers and final wholesalers, sourcing from wholesalers and selling to retailers. Wholesalers not selling to retailers or other wholesalers are ignored. For the categories of source wholesalers and intermediate wholesalers, we assume that a significant fraction sells to wholesalers who do not then supply industrial users or overseas markets. The findings are as follows.

1. Primary wholesalers

- The number of direct trade wholesalers to retailers sourcing from Japanese producers and selling to retailers decreased from 28'525 in 1994 to 19'214 in 2002. These values represent a decrease of 32.5% between 1994 and 2002.
- The number of direct trade wholesalers sourcing from overseas and selling to retailers increased from 1'435 in 1994 to 2'030 in 2002. These values represent an increase of 41.5% between 1994 and 2002.

2. Source wholesalers

- The number of source wholesalers buying from producers and selling to wholesalers decreased from 15'843 in 1994 to 13'302 in 2002. These values represent a decrease of 16.0% between 1994 and 2002.
- The number of source wholesalers buying from overseas and selling to wholesalers increased from 1'435 in 1994 to 2'030 in 2002. These values represent an increase of 43.6% between 1994 and 2002.

3. Secondary wholesalers

- Intermediate wholesalers: The number of intermediate wholesalers increased from 16'211 in 1994 to 21'579 in 2002. These values represent an increase of 33.1% between 1994 and 2002.
- Final wholesalers: The number of final wholesalers sourcing from wholesalers and selling to retailers decreased from 36'668 in 1994 to 33'624 in 2002. These values represent a decrease of 8.3% between 1994 and 2002.

The results of the data analysis match our expectations except for the increase in the

number of intermediate wholesalers by 33.1% between 1994 and 2002, which stands in contrast to all expectations.²⁶

4.2.4 Improved wholesale circuitry

One measure that is frequently used to define wholesale circuitry is the W/R ratio, which is the ratio of total wholesale sales (W) to total retail sales (R). A low W/R ratio indicates short marketing channels, while a high W/R ratio indicates extended marketing channels.

Based on total retail sales and total wholesale sales, wholesale circuitry was calculated to range from 4.9 in 1966 to 3.0 in 2004. Between 1991 and 1994, the W/R ratio dropped from 4.1 to 3.6 and then to 3.2 in 1997. In 2004, there were still as many as three wholesale steps on average between the manufacturer and the consumer (see Table 11).

²⁶ This is even more surprising because total sales within this wholesaler category remained more or less stable; between 1994 and 2002, sales decreased by 1.5%. See METI (2004).

Table 11: The W/R ratio, 1958-2004

Year	Total wholesale sales*	Total retail sales*	W/R ratio
1958	13'986'607	3'548'626	3.9
1960	18'468'273	4'315'387	4.3
1962	27'473'567	6'148'961	4.5
1964	38'830'071	8'349'588	4.7
1966	52'082'304	10'683'623	4.9
1968	62'816'763	16'507'256	3.8
1970	88'330'893	21'773'438	4.1
1972	106'780'082	28'292'696	3.8
1974	173'113'132	40'299'895	4.3
1976	222'315'445	56'029'077	4.0
1979	274'545'131	73'564'400	3.7
1982	398'536'234	93'971'191	4.2
1985	427'750'891	101'718'812	4.2
1988	446'483'972	114'839'927	3.9
1991	573'164'698	140'638'104	4.1
1994	514'316'863	143'325'065	3.6
1997	479'813'295	147'743'116	3.2
1999	495'452'580	143'832'551	3.4
2002	413'354'831	135'109'295	3.1
2004	405'646'439	133'278'631	3.0

*In mio. JPY

Source: Based on the Statistics Bureau, Ministry of Internal Affairs and Communications; Historical Statistics of Japan, Chapter 13, Domestic Trade, 13-1; METI, Census of Commerce 2004.

There are two basic problems with the W/R ratio when it is used to determine the structure of the wholesale industry. The W/R ratio was originally used to capture the relationship between two economic sectors, namely the wholesale sector (W) and the retail sector (R). It is, however, not adequate to determine the internal structure of the wholesale market. Japan's wholesale sales include exports, direct sales to industrial users that do not pass through the retail market, and transactions between headquarters and branch offices of the same company. Nishimura (1993) writes that because of this classification, the ratio of wholesale to retail sales in Japan seems large when compared

with similar metrics for the United States and European countries (see Nishimura, 1993: 104).

In addition, as Ito and Maruyama (1990) have pointed out, a high W/R ratio may be the result of the following:

“Instead of the wholesale being multi-layered, the retail establishments may be especially small size. If the retail sales per establishment (...) are small due to its small-scale operations (...), then a high W/R ratio would be obtained. Therefore, the W/R ratio alone is not conclusive evidence of the multi-layered nature.” (Ito and Maruyama, 1990: 12)

Due to this apparent weakness of the W/R ratio, Nishimura (1993) has advocated the use of the w/W ratio to measure wholesale circuitry. Used as an indicator for the degree of circuitry or the length of wholesale marketing, the w/W ratio is defined as

$$w/W \text{ ratio} = \mu = (\text{sales from wholesalers to other wholesalers}) / (\text{total wholesale sales})$$

Note that μ indicates the existence of multiple stages (i.e., more than two stages), while S indicates the number of wholesaler stages (see also Graph 7):

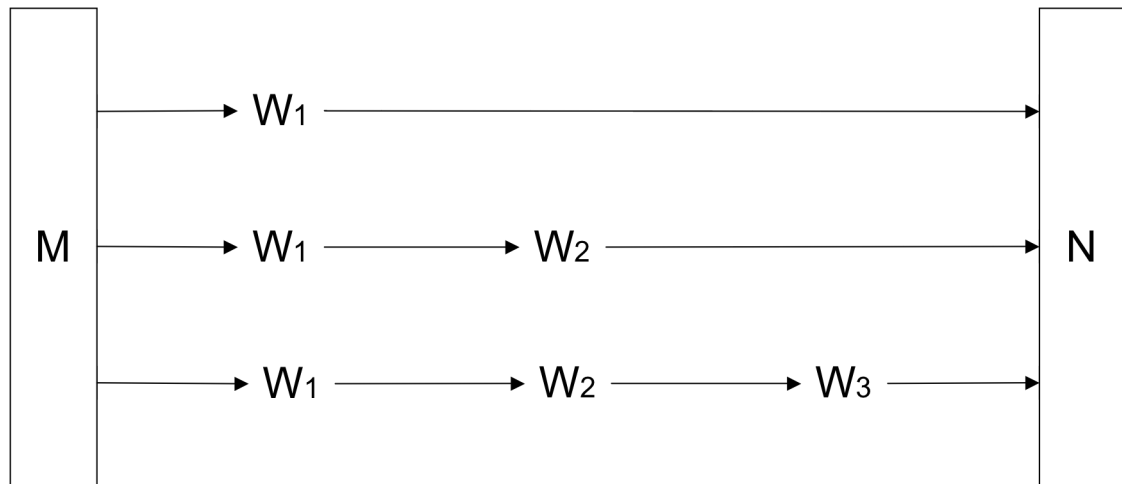
If $S=1$, then $\mu=0/1=0.00$ in the M-W1-N structure.

If $S=2$, then $\mu=1/2=0.50$ in the M-W1-W2-N structure.

If $S=3$, then $\mu=2/3=0.66$ in the M-W1-W2-W3-N structure.

If $S=4$, then $\mu=3/4=0.75$ in the M-W1-W2-W3-W4-N structure.

Graph 7: Wholesaler stages



M: Manufacturers; W: Wholesalers; N: Retailers, industrial users, overseas retailers, and consumers

Source: Nishimura, 1993.

Nishimura's findings suggest that the length of Japan's wholesale channels does not warrant the strong criticism from European countries and the United States. According to his calculations, the average number of wholesale stages in Japan from 1968 to 1988 was 1.57, while the average number of steps in wholesale channels in the United States from 1972 to 1987 was 1.30.

METI (2005) has published w/W ratios for various types of wholesalers (see Table 12). The w/W ratio across all wholesale types peaked in 1979 at 1.74, whereas the average w/W ratio for the years 1976 to 2002 was 1.64.

The w/W ratio for wholesalers that trade in consumer goods peaked in 1979 at 1.83. In 2002, this metric decreased to 1.65. The most substantial decrease was recorded between 1991 and 1994, from 1.71 to 1.64.

Table 12 also shows substantial differences in the w/W ratio across the various types of wholesalers based on the goods they handle. While wholesalers dealing with industrial and consumer goods have similar average w/W ratios of 1.75 and 1.74, respectively, the wholesale channel for capital goods is shorter, with an average of 1.45 wholesale steps.

Table 12: The w/W ratio, 1976-2002

Year	All wholesalers	Wholesalers dealing with producers / industrial goods	Wholesalers dealing with capital goods	Wholesalers dealing with consumer goods
1976	1.71	1.92	1.56	1.80
1979	1.74	1.90	1.52	1.83
1982	1.72	1.82	1.43	1.80
1985	1.60	1.68	1.42	1.80
1988	1.62	1.70	1.44	1.75
1991	1.65	1.77	1.41	1.71
1994	1.62	1.70	1.39	1.64
1997	1.54	1.63	1.42	1.66
2002	1.56	1.62	1.47	1.65
Ave- rage	1.64	1.75	1.45	1.74

Source: METI, 2005.

Like the W/R ratio, the w/W ratio also has its shortcomings:

- The w/W ratio does not include sales that avoid the wholesale markets, such as direct sales by manufacturers to consumers or retailers. Therefore, this measure is not entirely adequate for a complete analysis of the multi-staged structure of wholesale in general, but it remains helpful for analyzing trends in the circuitous structure of the wholesale sector (see Nishimura, 1993: 104).
- Like the W/R ratio, the w/W ratio includes wholesale sales such as exports, direct sales to industrial users that do not pass through the retail market, and transactions between the headquarters and branch offices of a company.

In order to correct these shortcomings, Nariu and Flath (1993) introduce a proxy for measuring the number of wholesale steps (NS), defined as the natural logarithm of the total mark-up divided by the natural logarithm of the average mark-up (for details, see Nariu and Flath, 1993: 83-84):

$$NS = \frac{\ln (P_N / P_0)}{\ln (P_j / P_{j-1})}$$

Note that NS is the number of wholesale steps; P_0 is the price at which manufacturers sell a product to a primary wholesaler; P_N is the price at which the last wholesaler in the chain sells a product to a retailer; and P_j/P_{j-1} is the average mark-up.

Nariu and Flath analyze the length of wholesale marketing channels in Japan and the United States by matching various kinds of wholesale businesses; they then compute the number of wholesale steps for 40 different kinds of businesses in Japan in 1986 and 44 different kinds of businesses in the United States in 1982 for both durables and non-durables (see Table 13 and Table 14) (see Nariu and Flath, 1993: 84ff). Their results can be summarized as follows:

- The average number of steps across all kinds of businesses is 1.48 for Japan and 1.36 for the United States.
- Although the positive difference between the number of wholesale steps in Japan and the number in the U. S. is small, the difference is pervasive and not limited to specific products. It is, however, not applicable for motor vehicles, hardware and petroleum.
- There is a clear tendency for products that have long marketing channels in one country to also have long channels in another. Products such as fresh fish have longer channels in both Japan and the United States
- The types of products whose Japanese and U.S. versions exhibit the greatest difference in terms of the number of steps are china and glassware, curtains and draperies, lumber, building materials, paper, and canned goods.

Table 13: The estimated number of wholesale steps: Japan in 1986 and the United States in 1982 according to type of wholesale business – nondurables

United States		Japan	
Type of business	NS*	NS	Type of business
Nondurables	1.49		
Paper and paper products	1.20	1.47	Paper and paper products
General line drugs	1.04	1.16	Drugs
Specialty line pharmaceutical, cosmetics and toiletries	1.19	1.34	Toiletries and allied products
Piece goods	1.92	1.6	Textiles except interior decoration
Notions and other dry goods	1.38	1.5	Miscellaneous apparel, apparel accessories and notions
Men's and other dry goods	1.12	1.22	Men's clothing
Women's, children's and infants' apparel	1.17	1.31	Women's and children's clothing
Footwear	1.31	1.14	Shoes
Dairy products	1.81	1.67	Miscellaneous food and beverages including dairy products
Poultry and meat	1.57	1.68	Meat and poultry
Confectionary	1.51	1.45	Bakery and confectionary products
Fish and seafood	2.27	2.56	Fresh fish, shellfish and seaweed
Fresh fruits and vegetables	1.73	1.86	Vegetables and fruits
Coffee, tea and spices	1.35	1.67	Tea
Canned goods	1.18	1.76	Canned goods and bottled goods
Farm products	1.42	1.45	Miscellaneous farm, livestock and aquatic products
Chemical and allied products	1.19	1.45	Chemicals and related products except paints
Petroleum and petroleum products	1.74	1.53	Petroleum
Alcoholic beverages	1.24	1.36	Beer, wine and liquor
Farm supplies	1.47	n.a.	Fertilizers and feeds
Tobacco and tobacco products	1.10	n.a.	Tobacco products
Paints, varnishes and supplies	1.19	1.37	Paints and related products

*=Number of wholesale steps; refers to the number of separate title-holding intermediaries interposed between a manufacturer and retailers and or individual demanders.

Source: Nariu and Flath, 1993.

Table 14: The estimated number of wholesale steps: Japan in 1986 and the U. S. in 1982 according to the type of wholesale business – durables

United States		Japan	
Type of business	NS*	NS	Type of business
Durables	1.27		
Motor vehicles	1.87	1.14	Motor vehicles
Automotive parts and supplies	1.59	1.51	Motor vehicles parts and accessories
Furniture	1.61	1.29	Furniture and fixtures
China, glassware and crockery	1.04	1.41	Chinaware and glassware
Linens, domestics, curtains and draperies	1.11	1.48	Textiles, interior decoration
Floor coverings and other home furnishings	1.26	1.48	Miscellaneous home furnishings
Lumber, plywood and millwork	1.32	1.68	Limber and bamboo
Brick, stone, sand, tile and cement	1.24	1.68	Cement
Flat glass and other construction materials	1.32	1.58	Sheet glass
Construction materials n.e.c.	1.10	1.68	Miscellaneous building materials
Sporting and recreational goods, toys and hobby goods	1.27	n.a.	Sporting goods, recreational goods and toys
Photographic equipment and supplies	1.48	1.33	Precision instruments including camera equipment
Ferrous metal	1.51	1.72	Iron and stell
Nonferrous metal	1.25	1.51	Nonferrous metals
Coal	1.14	1.51	Coal
Electrical goods other than house appliances	1.15	1.25	Electrical machinery, apparatus and supplies except household appliances
Electric house appliances, tv and radio sets	1.56	1.25	Electrical household appliances
Hardware	1.21	1.16	Hardware
Machinery equipment, n.e.c.	1.15	1.36	General machinery and equipment
Surgical, medical and hospital supplies	1.06	1.16	Surgical goods
Transportation equipment and supplies except motor vehicles	1.16	1.36	Transportation equipment except motor vehicles
Iron and steel scrap	1.21	n.a.	Iron scraps
Waste and secondary materials	1.24	n.a.	Nonferrous scraps
Forest products except lumber	1.08	n.a.	Firewood

*=Number of wholesale steps; refers to the number of separate title-holding intermediaries interposed between a manufacturer and retailers and or individual demanders.

Source: Nariu and Flath, 1993.

Nariu and Flath (1993) find that both consumer goods and industrial goods have longer wholesale channels in Japan; they conclude that the fragmentation of industrial customers might have a similar influence on the wholesale structure, as the ubiquity of retail stores. Not all wholesale marketing channels in Japan, however, have more steps. Goods with relatively few steps in Japan include motor vehicles and electric appliances. Nariu and Flath (1993) argue that the coordination of channel members through distribution *keiretsu* favors less complex wholesale channels.

Maruyama (2004) introduces yet another ratio that can be used to determine wholesale circuitry called the wholesaler use ratio. It is defined as follows:

$$\text{Wholesaler use ratio} = \frac{(\text{sales of retail direct trade wholesalers}) + (\text{sales of source wholesalers})}{\text{total retail sales}}$$

Maruyama (2004) achieves two findings: firstly, a decline in the number of consumer goods wholesalers; and secondly, a sharp decline in the wholesaler use ratio in the 1990s and accelerating trend of bypassing wholesalers altogether (see Maruyama, 2004: 31). He also notes that like the W/R ratio, the wholesaler use ratio is just an approximate estimation method. This is the case because the sales of other direct transaction wholesalers can be excluded when determining the wholesaler use ratio for products sold by retailers, as their goods are sold to industrial customers and foreign companies. However, source wholesalers' sales will include sales of goods that are not ultimately destined for retailers, while the sales of other wholesalers will include some goods to retailers. The magnitude of that fraction of goods is not known.

If we review the various measures for wholesale circuitry, it becomes apparent not only that the results yielded using the various measures differ but also these measures are only estimates. Therefore, we cannot reach a final conclusion regarding whether or not wholesale circuitry has improved.

4.2.5 An increase in direct sourcing between retailers and manufacturers

The issue of direct sourcing attracted substantial attention when large foreign retailers entered Japan. It was expected that foreign retailers would not comply with Japanese

local customs and would avoid wholesalers whenever possible. Nishimura (2004: 168) writes that due to the complex distribution system in Japan, global retailers bring their own distribution system, trade customs and business models into the Japanese market. They are interested in direct trade relationships with suppliers because they believe that the long and multi-level channel leads to high-cost transactions. It was also expected that this new way of doing business would eventually spill over to key players in the Japanese retail industry.

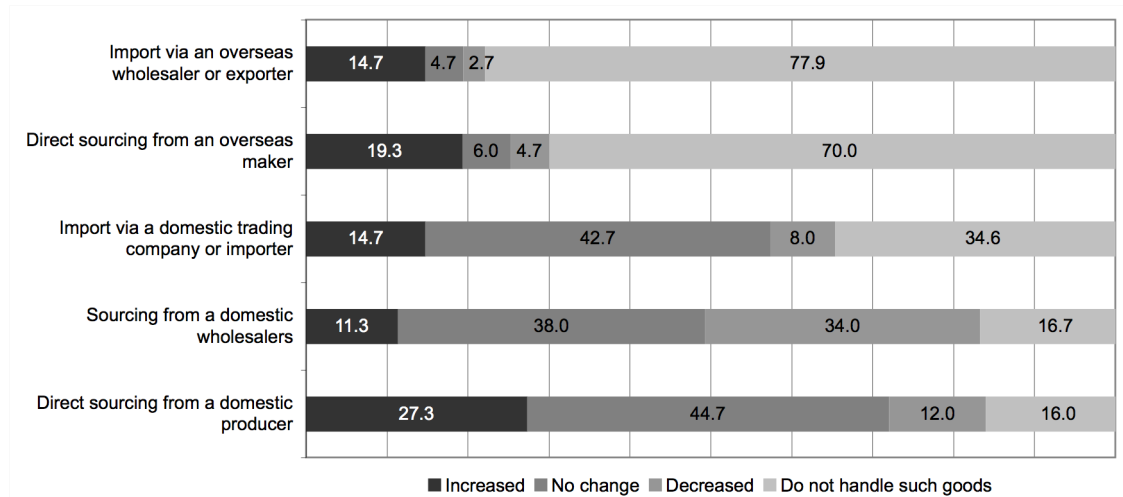
Graph 8: Missing data on direct sourcing

Missing data is represented using the dotted line.

Japan's Manufactured Imports Promotion Organization (MIPRO) published a study in

2002 on direct sourcing trends and the globalization of sourcing activities by companies active in the distribution sector. According to that study, sourcing from domestic wholesalers decreased by 34.0%, and 27.3% of all respondents indicated they increased their direct sourcing from a domestic producer (see Graph 9) (see MIPRO, 2002).

Graph 9: Changes in the sourcing routes of Japanese retailers (expressed as percentages)



Source: Mipro, 2002: 51.

The significance of the study, however, is limited, and it is not clear how valid, reliable, and representative the results are. The response rate for the study was only 19%. This 19% metric corresponds to 380 companies that are active in distribution, including 150 retailers. The latter also include non-store retailers such as Internet companies (19 businesses) and mail-order companies (15 businesses). Because the business models and industry dynamics of the Internet and mail order businesses differ significantly from those that are standard in traditional retailing, they may also use different sourcing strategies (see, for example, Wongtada and Zerio, 1993).

Due to a lack of reliable data, claims of increased direct sourcing can be neither confirmed nor rejected.

4.3 Summary

In this chapter, we have looked for quantitative evidence for the following expected developments:

- An increase in the number of large stores.
- A decrease in the number of small traditional retailers.
- A decrease in the number of wholesalers.
- Improved wholesale circuitry.
- More direct sourcing between retailers and manufacturers.

Our quantitative findings can be summarized as follows.

- (1) **Expectation:** The number of large stores (measured in terms of sales floor area) will increase.

Finding: Confirmed; there is a correlation between the number of large stores and the revision of the Large-Scale Retail Stores Law. Causality, however, is questionable. Also, the rate of change was slower than expected.

- (2) **Expectation:** The number of small traditional retailers will decrease.

Finding: Confirmed; however, the number of small retail stores started to decline between 1982 and 1985, rather than after the revision of the Large-Scale Retail Stores Law.

- (3) **Expectation:** The number of wholesale establishments will decrease.

Finding: Partly confirmed; there is an overall negative trend; however, between 1994 and 2002, the number of intermediate wholesalers increased by over 30%.

- (4) **Expectation:** The wholesale circuitry will improve.

Finding: Not confirmed. The ratios used to determine wholesale circuitry produce different results, and all of them are approximate methods.

- (5) **Expectation:** Large stores increasingly circumvent the wholesale level and source directly from manufacturers.

Finding: Not confirmed due to a lack of quantitative data.

These findings suggest that the Large-Scale Retail Stores Law was not the main factor shaping the structure of the Japanese retail market and that the large number of small retailers was not the decisive factor in the creation of the multi-layered wholesale sector

in Japan. The data also raise the question of what factors (if not legislation) did shape the structure of the Japanese distribution system.

We proceed as follows: With regard to retailer size, we critically assess the associated changes, thereby also addressing the factors *technology*, *shopping habits* and *geographic environment* from our conceptual framework (see Graph 1). This should shed light on the slow increase in the large number of large retailers and the initial decrease in the number of small retailers between 1982 and 1985. We also assess the revised statute (*legislation*).

In considering the issue of direct sourcing, an analysis of retailers' *resources* and the distribution of channel *power* should enable us to make an assertion regarding why the number of intermediate wholesalers increased between 1994 and 2002 and whether or not direct sourcing increased after the revision of the statute.

In summary, we address the following trends in the next chapter:

- The slow increase in the number of large-scale retail stores after the revision of the Large-Scale Retail Stores Law.
- The beginning of a decrease in the number of small retailers between 1982 and 1985.
- The issue of direct sourcing.
- The greater-than-30% increase in the number of intermediate wholesale establishments between 1994 and 2002.

5 Further analysis

5.1 The slow increase in the number of large-scale retail stores

In this section, the revised statute and associated changes will be further analyzed with the aim of reporting possible explanations for the slow rate of increase in the number of large stores.

5.1.1 The revision of the Large-Scale Retail Stores Law

Claim: Once the Large-Scale Retail Stores Law is revised, the number of large stores will substantially increase.

It is important to note that the revision of the Large-Scale Retail Law did not produce a free market and that certain regulations remained in place. Under the revised statute, the planning process is more rapid, but it still takes one and a half years from the time of application to receive the proper permission (see Davies and Itou, 2001: 92-93). Furthermore, in 2000, the “Law Concerning the Measures by Large-Scale Retail Stores for Preservation of the Living Environment” went into effect in 2000 and replaced the Large-Scale Retail Stores Law. Under this law, all stores larger than 1’000 m² required approval. Guner, Ventura and Yi (2006) argue that the new legislation is even more restrictive than the Large-Scale Retail Stores Law. Under the new law, the restrictions on size begin at 1’000 m². While retail stores between 500 m² and 1’000 m² are unrestricted, all proposals for retail space above 1’000 m² are considered locally. Local governments are unlikely to promote large retail stores because they will not see net benefits from a more competitive retail environment and from the taxation of businesses. Although the affected parties remain a critical part of the application process, the protection of small retail stores is no longer an explicit objective. Environmental protection (noise, congestion), however, is now taken into account and constrains retailers wishing to expand (see Davies and Itou, 2001: 92-93). The idea of using valuable land to build mega-stores is opposed by the The Ministry of Agriculture, Forestry and Fisheries and strikes a common chord with many Japanese people (see Riethmuller and Chai, 1999: 11).

The Economist (2000) has articulated concern that although the new law no longer explicitly protects small-shop owners, it still may be used to shield them from the big-store chains because the responsibility for drawing up the ground rules has passed from MITI to Japan's prefectural and metropolitan governments, which might give more power to small shop owners.

Findings: The revision of the Large-Scale Retail Stores Law did not produce a free market in which large stores were able to expand at will. Certain regulations remained in place. In addition, the new law (Law Concerning the Measures by Large-Scale Retail Stores for Preservation of the Living Environment) that went into effect in 2000 and replaced the Large-Scale Retail Law no longer explicitly protects small-shop owners, but it still may be used to shield small retail stores from the big-store chains.

5.1.2 Associated changes

5.1.2.1 The increase in car ownership

Claim: Car ownership has increased and triggered a change in shopping behavior, with Japanese households now shopping less frequently and increasingly shopping in bulk. Because increasing numbers of households rely on cars for shopping trips, the attractiveness of large stores has increased.

Two factors have discouraged the widespread use of cars for shopping purposes.

1. Car ownership is still low in comparison with that in other nations: In 1983, Japan had 0.220 private vehicles per person, which is less than half the figure for the United States (with 0.535), even though the Japanese economy is frequently compared with the United States economy (see Table 15).

Table 15: Private and commercial vehicles per person, retail stores per 1'000 persons, 1983*

Country	Cars: Private vehicles per person	Trucks: Commercial vehicles per person	Stores: Retail stores per 1'000 persons
Brazil	0.071	0.014	6'680 (80)
Ecuador	0.010	0.018 (81)	8'676 (80)
Finland	0.289	0.036	7'410 (82)
Greece	0.108	0.056	1'6229 (78)
Iceland	0.402	0.050	7'954 (82)
Ireland	0.205	0.021	9'146 (77)
Japan	0.220	0.131	1'4340 (82)
Netherlands	0.328	0.025	6'223
New Zealand	0.438	0.089	9'345
Norway	0.334	0.047	8'211
Singapore	0.086	0.045	6'507 (81)
Syria	0.013	0.011	7'637 (75)
Turkey	0.018	0.007	5'843 (80)
France	0.351	0.054 (82)	10'300 (82)
W. Germany	0.402	0.026	6'600 (84/85)
U.K.	0.286	0.041	6'200 (82)
U.S.	0.535	0.157	6'100 (87)

*Unless otherwise indicated in ()

Source: Flath and Nariu, 1996: 189.

By 2004, the number of private vehicles per person in Japan had increased to 0.333 (see Table 16). However, not only did the increase in that number significantly slow during the years following 1995, this figure also continues to substantially lag behind the United States numbers for 1985 (see Table 15).

Table 16: Private passenger cars in Japan, 1980-2004

Year	Total passenger cars for private use (in 1'000)	Population (in 1'000)	Passenger cars for private use per person	Growth in %
1980	21'293	117'060	0.182	-
1985	25'595	121'049	0.211	16.2
1990	32'177	123'611	0.260	23.1
1995	38'846	125'570	0.309	18.8
2000	42'108	126'926	0.332	7.2
2004	42'506	127'687	0.333	0.3

Source: Statistical Yearbook of Japan 2006.

The reason for this slowdown may be linked with the economic stagnation as well as with the limited space for and/or the cost associated with parking lots at home. Also, owning a car in Japan is costly. Car owners are required by law to submit their vehicles to comprehensive inspections (*shaken*). These inspections start during a car's third year on the road and must be completed after every two years thereafter until a car's eleventh year on the road; after that, inspections must be performed every year. Numerous working parts must be replaced if an older car is to pass (see Beck, 1993: 282).

2. Cars are not used significantly for shopping purposes: According to Takeuchi and Bucklin (1977: 45), cars were not significantly employed for shopping purposes in the 1970s for the following reasons:

- Relatively few shopping centers had been newly constructed, and existing retailers were unable to provide parking facilities.
- Japanese consumers found it much more convenient to purchase goods at neighborhood shops than to make a major effort to shop at a distance by car.
- Men of a given household tended to use the automobile, and they generally used it for non-shopping purposes.

Odagiri and Riethmuller (2000) find that the increase in the number of private vehicles per person since the 1970s did not impact shopping behavior as much as expected. As

can be seen in Table 17, in Fukuoka in 1996, a third of people shopped almost daily (30.1%) and not by car (38.3%). Overall, 42.2% shopped up to 3 times a week. Moreover, 45% used the car often, 39.9% used it occasionally, and 37.0% did not use it at all. Interestingly, of the people shopping once per week, only 24.3% indicated that they used their car often.

Table 17: Shopping frequency and use of car in Fukuoka, 1996

Item	Almost every day (%)	2 to 3 times per week (%)	Once a week (%)
Shopping frequency	30.1	42.2	21.2
Use of car			
Often	26.2	45.0	24.3
Occasionally	34.5	39.9	19.4
Not used	38.3	37.0	11.1

Odagiri and Riethmuller, 2000: 60.

They conclude that ownership of a car does not necessarily lead to a decrease in shopping frequency and an increase in bulk purchases (see Odagiri and Riethmuller, 2000: 59).

In addition, Odagiri and Riethmuller (2000) found that the shorter the amount of time spent on shopping, the greater the use of private cars, as Table 18 shows.

Table 18: Time spent shopping and mode of transport in Fukuoka, 1996

Time spent	On foot (%)	By bicycle (%)	By private car (%)
Up to 5 min.	52.9	47.9	42.1
5-10 min.	30.4	40.7	31.2
10-20 min.	13.1	8.8	21.1
20-30 min.	0.5	-	3.4
30-40 min.	-	-	0.2
Other responses	3.1	2.6	2.0
Total	100.0	100.0	100.0

Source: Food and Agricultural Policy Research Center 1997 in Odagiri and Riethmuller, 2000: 60.

Shopping by car in Japan is cumbersome because roads are often congested and few parking lots are available. A significant portion of Japan's land mass is mountainous, and habitable land is scarce. The vast majority of Japan's 125 million people are forced to live and work in coastal areas, and this land is extraordinarily expensive. To conserve valuable land area, minimal space is allotted to roads, boulevards and other transportation infrastructure; for example, 3% of total land area was dedicated to these purposes in 2000 (see Table 19). Even in rural areas, streets are often no wider than the width of a typical car and are frequently unpaved (see JAMA, 1998).

Table 19: Land area by use per 1'000 square kilometers

Year	Total	Farmland	Forest and grassland	Inland water	Roads	Built-up land 1)	Other
1990	377.7	53.3	255.2	13.1	11.4	16.0	28.7
1995	377.8	51.3	254.0	13.2	12.1	17.0	30.3
2000	377.9	49.1	253.8	13.5	12.7	17.9	30.9
In % 2000	100.0	13%	67%	4%	3%	5%	8%

1) Including industrial land and other land for building.

Source: Statistics Bureau of Japan, Japan in Figures 2006.

Although the total United States land area is 26 times larger than that of Japan, the

United States has only six times the number of miles of road and three times more vehicles on the road (see Table 20).

Table 20: A comparison of the total area, population, road mileage, and vehicle counts for the United States, Japan, and California

	U.S.	Japan	California
Total area (sq. miles)	3'787'318	145'850	155'937
Population	266'476'278	125'449'703	31'210'750
Total roads (miles)	3'905'834	691'637	168'328
Vehicle count	201'530'021	66'853'500	2'241'749

Source: JAMA, 1998.

Odagiri and Riethmuller (2000: 59) therefore consider population density to be a critical factor in shaping shopping habits. The high population density in Japan leads to crowded roads in major population centers and congested parking areas, which then results in consumers shopping locally and often.

Findings: The private car ownership rate has increased, but it remains low compared with that of the United States. Studies have found that increased ownership of a car in Japan failed to decrease shopping frequency and did not lead to an increase in bulk purchases. Shopping locally is more efficient because roads in major population centers are often crowded and parking areas are often congested (*geographic environment*).

5.1.2.2 The increase in private label products

Claim: Japanese consumer sophistication and price-consciousness increased, while brand consciousness decreased. Retailers responded to this trend by introducing their own private label products. This increased the attractiveness of retailers' consumer image and reduced their dependence on branded goods and, in turn, on manufacturers and wholesalers.

Private label products are not new to the Japanese consumer market. In response to a 1967 survey of supermarkets in Tokyo, 36% of 376 firms indicated that they were selling merchandise under their own brand. The products most frequently sold under

private labels include soup, canned fruits, cooking oil, instant coffee, men's socks, dress shirts, sheets, women's blouses, stockings, and underwear (see Yoshino, 1971: 159).

However, the number of private label products in supermarkets was limited at that time. Supermarkets competed mainly by selling branded goods. In a few exceptional cases, conflicts of interests have led to friction between manufacturers of branded goods that are trying to control prices at all levels of the distribution system and supermarkets that wish to offer products at low prices (see Nihon Keizai Shinbunsha, 1995: 66).

Has the share of private label products in Japan increased significantly in recent years? ACNielsen (2005) compares retail sales across 38 countries for 80 categories and lists the value share of private label products and growth rates of private label products in each country (see Table 21).²⁷ Their findings are as follows:

1. Value share of private label products: The share of private label products was 17% in 2005 as compared to 15% in 2003 across all countries and categories. The share of private label products varied widely across the countries included in the study. Switzerland recorded the highest share of private label products at 45%, while the Philippines registered the lowest at less than 1%. The emerging markets in Asia Pacific and Latin America had less developed private label markets than did Europe or North America. Japan's share of private label products was 4%, with no change from the figures in the 2003 report.

²⁷ This list is based on sales volume rather than on the number of products. We assume that the number of private label products is correlated with sales volume.

Table 21: Value share of private label (PL) by country, 2005

Country	Region	PL Share	Country	Region	PL Share
Switzerland	Europe	45%	Norway	Europe	8%
Germany	Europe	30%	Ireland	Europe	7%
Great Britain	Europe	28%	Czech Republic	Emerging Markets	7%
Spain	Europe	26%	Hong Kong	Asia Pacific	4%
Belgium	Europe	25%	Brazil	Latin America	4%
France	Europe	24%	Greece	Europe	4%
Netherlands	Europe	22%	South Africa	Emerging Markets	4%
Canada	North America	19%	Puerto Rico	Latin America	4%
Denmark	Europe	17%	Japan	Asia Pacific	4%
United States	North America	16%	Israel	Europe	3%
Sweden	Europe	14%	Singapore	Asia Pacific	3%
Austria	Europe	14%	Chile	Latin America	3%
New Zealand	Asia Pacific	12%	Argentina	Latin America	3%
Italy	Europe	11%	Colombia	Latin America	2%
Portugal	Europe	11%	Croatia	Emerging Markets	2%
Hungary	Emerging Markets	10%	Thailand	Asia Pacific	1%
Slovakia	Emerging Markets	10%	Mexico	Latin America	1%
Finland	Europe	10%	South Korea	Asia Pacific	1%
Australia	Asia Pacific	9%	Philippines	Asia Pacific	>0.5%

Source: ACNielsen, 2005: 9.

2. Growth rate of private label markets: In the ACNielsen 2003 report, Japan ranked tenth among the top ten fastest-growing private label markets. Growth rates were highest in the Asia Pacific region, emerging markets, and Latin America (see Table 22).

Table 22: Top ten fastest-growing private label markets, 2003

Country	Region	PL Growth
Poland	Emerging Markets	115%
Philippines	Asia Pacific	48%
Czech Republic	Emerging Markets	44%
Hungary	Emerging Markets	44%
Thailand	Asia Pacific	35%
Colombia	Latin America	31%
Argentina	Latin America	31%
South Africa	Emerging Markets	28%
Sweden	Europe	25%
Japan	Asia Pacific	23%

Source: ACNielsen, 2003: 9.

ACNielsen (2003: 3) attributed these growth rates to the expansion of large multinational retailers in these regions that are introducing private label products. Indeed, many large foreign retailers entered Japan around 2000. Two years later, however, Japan had dropped off the list of the fastest-growing private label markets (see Table 23).

Table 23: Top ten fastest-growing private label markets, 2005

Country	Region	PL Growth
Croatia	Emerging Markets	77%
Greece	Europe	24%
Thailand	Asia Pacific	18%
Argentina	Latin America	18%
South Korea	Asia Pacific	17%
Finland	Europe	16%
Spain	Europe	16%
Singapore	Asia Pacific	16%
Colombia	Latin America	15%
Hungary	Emerging Markets	15%

Source: ACNielsen, 2005: 11.

Both the value share and the market growth rate of private label products in Japan are still low compared with that of other nations. The brand-consciousness of Japanese consumers may not have diminished as much as has been reported elsewhere. ACNielsen (2005: 6) reports another interesting fact: that the level of retail concentration is closely aligned with the extent of private label development. Except for the United States, nine of the top ten countries exhibited retail concentrations (defined as the share of sales controlled by the top five retailers in the country) of over 60% (see Table 24).

Table 24: Retail concentration in the most well developed private label markets

Country	Region	PL share	Retailer concentration
Switzerland	Europe	45%	86%
Germany	Europe	30%	65%
Great Britain	Europe	28%	65%
Spain	Europe	26%	60%
Belgium	Europe	25%	80%
France	Europe	24%	81%
Netherlands	Europe	22%	64%
Canada	North America	19%	62%
Denmark	Europe	17%	89%
United States	North America	16%	36%

Source: ACNielsen, 2005: 10.

Retail concentration in Japan is low in comparison with that of other nations, and the metric did not change significantly between 1979 and 1994. The top 10 retailers in Japan had a retail concentration of 8.1% in 1979 and 9.0% in 1994 (see Table 25).

Table 25: Retail concentrations in Japan, 1979-1994 (expressed as percentages)

Year	Top 10 Firms	Top 25 Firms	Top 50 Firms	Top 100 Firms	Top 200 Firms
1979	8.1	13.0	16.3	19.7	23.4
1980	8.4	13.4	16.6	20.2	24.2
1981	8.8	14.0	17.4	21.1	25.2
1982	8.0	12.8	16.0	19.6	23.6
1983	8.1	13.0	16.3	20.1	24.3
1984	8.2	13.1	16.5	20.4	24.8
1985	8.4	13.4	17.0	21.0	25.6
1986	8.7	13.8	17.5	21.6	26.4
1987	8.9	14.1	17.9	22.1	27.2
1988	8.9	13.7	17.4	21.5	26.2
1989	9.7	15.0	18.9	23.2	28.2
1990	9.8	15.2	19.3	23.7	28.9
1991	9.0	14.0	17.9	22.1	27.1
1992	8.9	13.7	17.6	22.0	27.1
1993	8.9	13.6	17.7	22.3	27.5
1994	9.0	13.4	17.3	21.8	27.0

Source: Kuwahara, 2001: 113.

Boyland and Nicoletti (2001: 258) reported a retail concentration in Japan of 4% in 1997 for the top three firms and of 7% for the top ten firms, which is lower than the 1994 figure in Table 25.

Factors contributing to high retail concentration include the presence of aggressive discounters who sell a very limited selection of products (mainly shelf-stable food) at a very low price and with high purchase frequency (see ACNielsen, 2005: 7). In Japan, although shopping frequency is high, Japanese consumers expect a large selection, including a variety of fresh products. Japanese retailers have been expanding the number of products offered to compete on the basis of product selection rather than based on price (see also chapter 5.3.1.5). Both factors discourage increases in retail concentration.

Findings: The value share of private label products in Japan has not significantly increased but instead remains low as compared to that of other nations. The reasons for

this can be found either in the strong brand consciousness of Japanese consumers (*shopping habits*) or the low retail concentration, or in both. Therefore, it is assumed that the number of private label products has not significantly increased.

5.1.2.3 Larger dwellings

Claim: Dwelling space has increased. Therefore, households can store more, they need to shop less frequently, and they can buy more in bulk. This, in turn, enhances the attractiveness of large stores.

According to the Statistics Bureau of Japan (2007), the average dwelling size increased from 89 m² in 1988 to 95 m² in 2003. However, as Izuhara (2000) reported, in metropolitan areas where one can expect large and mega-retailers, the size of the average residence has fallen in recent years. In 1980, 42.4% of the total population was concentrated within a 50-km radius of the three top metropolitan centers: Tokyo, Osaka, and Nagoya. In 2000, the percentage of the national population that was concentrated within these three major metropolitan zones increased to 44.2% in an area that accounted for 5.9% of the nation's total land mass.

Our question, however, is whether dwelling size did actually have an impact on retail structure in Japan.

Studies suggest that the large number of small retailers in Japan may be due to families' inability to keep large stocks of perishables in Japanese homes (see, for example, Flath and Nariu, 1996). However, according to Marvel (1993: 156ff), this explanation does not fully explain the small size of retailers selling both consumer durables *and* non-durables. Store density is significantly higher in Japan not just for food stores but also for most other product categories, including consumer durables such as hardware, garden supplies, furniture, and fixtures (see Table 26).

Table 26: Store density by product category: Japan and the United States

Kind of business	Japan	United States	Japan/United States
All retailing	45.463	23.809	2.0
Hardware and garden supplies	1.502	1.096	1.4
General merchandise	0.099	0.553	0.2
Food	15.758	2.992	5.2
Motor Vehicles	1.331	1.601	0.8
Gasoline stations	1.439	1.677	0.9
Apparel	6.409	1.968	3.3
Furniture and fixtures	5.724	1.630	3.5
Drugs and toiletries	2.378	0.644	3.7
Liquor	2.978	0.514	5.8

Source: Marvel, 1993: 157; data as reported in Flath (1990).

There is no clear indication that people living in larger dwellings in Japan shop less frequently at larger stores and store more products at home. Thus, the relevance of dwelling size for retail structure remains questionable.

Findings: Average dwelling size has increased only in non-metropolitan areas. In metropolitan areas, where almost half of the population resides, the average housing size has actually decreased. The relevance of dwelling size for retail structure in Japan, however, is questionable. There is no clear indication that people living in larger dwellings prefer to shop less frequently at larger stores and stock up on products that they can store at home (*shopping habits*).

5.1.2.4 Distributional IT

Claim: As more and more retailers implement distributional IT, wholesalers are no longer needed to serve as order-processing intermediaries between retailers and manufacturers.

An alleged key driver of disintermediation is the adoption of distributional IT by large retailers. It has been reasoned that retailers that are equipped with POS systems and a direct link to manufacturers need no longer depend on wholesalers for merchandising

expertise or order-processing capabilities.

Miwa (2002) thus asks:

“‘Information technology’ (IT), together with ‘Internet’ and ‘e-commerce’, is the phrase of the day in contemporary Japan. (...) Computers and communication technology made remarkable progress, and that progress could potentially have transformed distribution. Did it?” (Miwa, 2002: 172)

At least by the late 1980s, this transformation had not yet occurred, as the JFTC study group concluded in 1989 (see Miwa, 2002: 172).

Miwa (2002) analyzed the impact of the 1980s IT boom on the distribution sector by focusing on two product groups, daily necessities and processed foods. He selected these two product groups because they are commonly available at general merchandising stores (GMS) and convenience stores (CVS) and because product bar codes are widely used at GMS and CVS. GMS and CVS are chains, and to most observers, they seem particularly well suited for computerized data processing (see Miwa, 2002: 172).

In analyzing the introduction of bar code scanners, Miwa (2002) noted a rapid increase in the product bar code diffusion rate and the number of retailers equipped with POS systems. According to Miwa (2002), this increase in the demand for POS systems reflects aggressive expansion in terms of the number of product items channeled through the distribution system, creating the need for computerized information management systems such as POS systems. The large number of product items is in part a function of more differentiated and fluid consumer tastes.

In 1987, a small food retailer in Japan displayed about 2’000 items, while a large supermarket had more than 10’000 items in each store on average. Kokubu, the largest food wholesaler at that time, distributed more than 100’000 items, of which more than 20’000 were newly introduced to the market between January and September 1987. The total number of newly introduced items in 1987 was approximately 28’000. In the United States, by comparison, 1’700 items were newly introduced, and between 700 and 800 disappeared from the market in 1986 (see Miwa, 2002: 176).

The adoption of POS systems was expected to allow retailers to become independent

from wholesalers and manufacturers with regards to merchandising and encourage direct sourcing and disintermediation. Disintermediation, however, did not take place. Miwa (2002) identified efficiency as the main factor preventing disintermediation. On account of the large number of original suppliers (or manufacturers) serving individual retailers, trading through wholesalers was more efficient in many cases. Observed failures of attempts at direct trading also suggested that distribution through wholesalers was more efficient. Itō-Yōkadō, one of the largest GMS chains in Japan, did not increase its share of direct trade with manufacturers when it restructured its business in the 1980s. Rather than changing its trade flows, it reorganized its physical distribution channels.

Miwa (2002) also noted that shortening the lead-time for delivery did not promote more direct trade between retailers and manufacturers. In addition, even though online ordering systems or inter-firm linked computer networks were installed, not all orders were placed using these systems.

Many manufacturers installed computer networks out of fear that they would not survive unless they successfully exploited computers to improve overall efficiency. Kaō, the largest manufacturer of daily hygiene products, created and implemented a sophisticated computerized online information system for its distribution channels. Competing manufacturers such as Lion followed. In 1986, Lion installed terminals at 146 wholesaler facilities to collect data on sales to retailers. Another daily necessities manufacturer named Uni-Charm had terminals installed at around 40 wholesaler sites, with plans to add more. However, many wholesalers rejected Uni-Charm's request because they already had Lion terminals and demanded a standardized system instead. They were afraid that too many terminals from different suppliers would lead to increasing operating costs (see Miwa, 2002: 182).

The same year saw the launch of Planet, an intra-industry Value Added Network (VAN, also called an intra-industry Electronic Data Interchange, or EDI, system). The immediate objective of Planet was the online exchange of order-entry data (i.e., data on wholesaler orders to manufacturers). It was projected that receiving and exchanging these data online would substantially decrease a manufacturer's operating costs by reducing both man-hour input and wholesaler-manufacturer communication errors. In

addition, stocking data (i.e., data on the manufacturer's delivery of products to wholesalers, including information from invoices and bills of sales), data on claims (i.e., manufacturer payment claims to wholesalers), and sales data (i.e., the details of a wholesaler's sales and its deliveries to retailers) were to be collected and exchanged. In July 1986, only eight manufacturers used Planet to receive ordering data. By 1989, this number grew to 11, and by July 1990, there were 16 manufacturers using Planet; by July 1994, there were 38. The number of wholesalers using Planet to send ordering data increased from just 1 in 1986 to 31 in 1989 (see Miwa, 2002: 183).

During the 1990s, the number of users increased from 42 in 1990 to 128 in 1994. The number of users consulting Planet for stocking and sales data (85 users in 1986, 239 users in 1989, and 250 users in 1994) remained larger than the number of those using it for placing orders.

The overall impact of Planet, however, was rather small:

“Even those figures might overstate the impact of Planet, because each manufacturer trades with so many wholesalers and vice versa. At the end of 1987 a core member manufacturer used Planet for data orders with 5 wholesalers, for stocking data with 126 wholesalers, for data on claims with 6 wholesalers, and for sales data with 54 wholesalers. (...) Among 2,000-3,000 daily necessities wholesalers, each Planet member manufacturer directly trades with about 1,000, and the aggregate share of trade with the top 100 wholesalers was 90%. Thus, most large and powerful wholesalers had already joined Planet by this time.” (Miwa, 2002: 183)

Even a small wholesaler in this sector trades with over 100 manufacturers, while a large wholesaler trades with 300 to 400 manufacturers. The number of manufacturers using Planet for ordering data exchange was too small to cover the investment cost for wholesalers to adjust their in-house system to Planet. Therefore, Planet's use would not improve wholesalers' efficiency.

In the processed foods sector, the application of distributional IT was even less successful. Although the number of manufacturers and wholesalers greatly outnumbered the number of those that sold daily necessities, the number of participants in Finet, which is similar to Planet but for the processed foods industry, was smaller; in

1994, 45 manufacturers and 150 wholesalers were signed up for Finet, while 63 manufacturers and 289 wholesalers used Planet (see Miwa, 2002: 184). There may be several explanations for the low adoption rate:

1. Government interference obstructed standardization: Many observers have argued that the government should help to standardize information management, claiming that telecommunication networks and computerized information should be part of the social infrastructure. In reducing the costs of system construction, communication, and information management for private firms, the government would help to promote the development and use of IT (see Miwa, 2002: 192). We know that the Japanese government promoted inter-firm systems, but did its expected role as catalyst increase standardization? According to Miwa (200), it did not.

“The theory behind the claim that the government should play a key role was textbook economics. (...) Real-world empirics are another matter. (...) Consider the comment of one manager at a large food wholesaler. Almost always, he claimed, more than one ministry intervened in the industry. Worse, the bureaucrats only rarely tried to coordinate their efforts with each other. Answering as they did to politicians who need to win votes, they almost always put priority on equality than on efficiency – reducing the value of the policy to the firms involved.” (Miwa, 2002: 192).

Prioritizing the equal treatment of all industry members, a policy reportedly often adopted by the Japanese government, reflects the interests of weaker members and sets the target speed of industry-wide system development at a rather low level. Front-runners are asked to slow down their pace, and because they expect the government to intervene, they tend to postpone their own research and development (R&D) activities; government interference necessarily removes any first-mover advantage.

2. There were many costs and conflicts of interest among potential stakeholders.

- **Coordination costs:** The design and adoption of an IT system involves the coordination of a potentially large number of stakeholders. Coordination costs tend to increase with the number of participants.
- **Disclosure of valuable information:** Demand prices for inter-firm systems vary

greatly because the value of any information drawn from the system differs from the perspective of individual firms. The demand price or value of any information depends on a firm's intra-firm system for decision-making and information flow, the firm's business know-how and its process for using such information. Because the coordination of an inter-firm system requires firms to disclose know-how and ideas, their value will fall as the number of firms with access to these data rises. This makes cooperation difficult.

- **Diverse demands on the system:** Demands regarding the type of data to be collected differ greatly among participants. The type of information that a firm values depends on its products, technology, history, market position, and so on. Moreover, to decide which IT systems are most appropriate, a firm must first review its own experiences and then determine what it requires from an IT system. Expectations vary greatly among firms, and reaching an agreement on system design can be very difficult.
- **Battle for leadership:** The design and function of an inter-firm system will influence the demand price of each firm and may lead to battles for leadership.
- **Needs for ongoing cooperation:** Cooperation and coordination not only must exist during a system's initial construction phase but also may be necessary when the system is complete and operational. Experience and business know-how will generate new ideas about how to improve the system. Thus, the growth and evolution of both intra-firm and inter-firm IT systems demand on-going cooperation.

Other industries have been more receptive to inter-firm IT systems. In the airline industry, for example, computerized reservation systems have been widely implemented (see Miwa, 2002: 188ff). How did the competitive environment of the airline industry differ from the Japanese distribution system? When do computerized information systems work? Why did airline companies experience valuable gains from computerization? Miwa (2002) explains the success of inter-firm IT systems in the airline industry as follows:

- Airline companies increased their profits by increasing the number of travel agents equipped with terminals. Without such a system, the increasing complexity of

distribution and inventory management of airline tickets would have been difficult to manage.

- The costs of increasing the number of agents with access to the terminals are marginal, and the average cost decreases as the number of agents grows.
- Travel agents do not need to provide any detailed information regarding airline service. Flight services are standardized, and the information does not need to be backed up by a heavy collection of samples or by a well-informed expert.
- There was no serious contest for leadership in the development of the inter-firm IT system (the SABRE reservation system). American Airlines took the lead, and small travel agents followed.
- Wholesalers did not play a critical role in the distribution of airline tickets. Otherwise, the coordination and development would likely have been more difficult.

Findings: The number of retailers introducing POS systems increased substantially in the 1980s, reflecting the increase in the number of products they handled. In contrast, inter-firm EDI systems were not widely adopted. Retailers continued to place orders through wholesalers. The introduction of distributional IT did not lead to disintermediation in the Japanese distribution system (*technology*).

5.1.3 Summary

Chapter 6.1 has critically assessed the revised statute, the associated changes and their impact on retail structure: i.e., an increase in the number of large retail stores. The results can be summarized as follows.

- Although procedures were simplified and retailers with floor space up to 1'000 m² were freed from regulation, restrictions on the expansion of large(r) retailers stayed in place even after the revision. In addition, a new law, replacing the Large-Scale Retail Stores Law, went into effect in 2000. While the new statute no longer explicitly protects small retailers, it constraints large retailers wishing to expand on the basis of environmental concerns (*legislation*).
- The attractiveness of large stores outside the neighborhood and city centers to the

Japanese consumer is limited due to high population density, leading to congested streets and highways as well as few car-parking facilities (*geographic environment*).

- Japanese consumers do not shop less frequently and/or buy larger quantities, even though it was expected that they would do so once increases in residence size and car ownership rates occurred. The private car ownership rate, however, in Japan is still low compared with that in other nations. Moreover, owning a car in Japan does not lead to a decrease in shopping frequency or an increase in bulk purchases. In addition, the average dwelling size has increased only in non-metropolitan areas, and there is no clear indication that people living in larger dwellings in Japan prefer to shop less frequently, shop at larger stores, or store more inventory at home (*shopping habits*).
- The prevalence of private brands is still lower than in other nations, and growth rates have slowed. Brand consciousness might not have diminished as assumed (*shopping habits*), or the low prevalence of private brands might be due to low retail concentration.
- POS systems have been widely adopted by larger retailers, but inter-firm EDI systems have not (*technology*). Retailers continue to order through wholesalers.

5.2 The initial decrease in the number of small retailers between 1982 and 1985

In this chapter, we analyze the causes of the decrease in the number of small retailers between 1982 and 1985.

The decrease in the number of retailers between 1982 and 1985 is also referred to as the “1985 shock.” It was a “shock” because the development ran contrary to the long-held belief that the Japanese distribution system was characterized by the presence of an excessive number of retail stores (see Takaoka, 1999b).

For Matsui and Yukimoto (2004), the main reasons behind the decline include the proliferation of car ownership and the increase in the size of residences. The authors base their empirical research on the social optimality model, which determines the

socially optimal store density, assuming that retail stores are located in a unit-circle market space. They claim that the location of retail stores depends on transport and storing costs for households. If consumers have relatively higher transportation costs than do retailers, the combined costs of distribution are economized by shifting more of the storage and reorder costs to retailers (see Matsui and Yukimoto, 2004: 50). The authors conclude that the decline in the number of retail stores is due to the proliferation of car ownership and the increase in the average size of dwellings. When household costs associated with shopping and storing goods decreased, the number of stores needed to assure efficiency in the sense of a minimum social cost of distribution decreased as well.

Another explication focuses on small stores as family businesses. Increasingly, members of store-owning families want to separate business and family and do not want their stores to be part of their own home (see Kikkawa and Takaoka, 1998: 108).

Neither explanation, however, addresses one important question. Why did the decrease begin in 1985 and manifest itself in the form of a decline in the number of small-sized food and beverage stores? As Table 27 shows, the store categories that declined most notably were the categories of small stores with two or fewer employees, stores dealing in foods and beverages, and mom-and-pop stores that were often run as family businesses with sole proprietorship and without regular employees.

Table 27: Retail stores according to size, business category, and structure, 1970-1991

Year	1970	1979	1982	1985	1988	1991
Number of retail stores (1'000)	1'471	1'674	1'721	1'629	1'620	1'591
Breakdown by size (%)						
2 persons or less	63.9	61.1	60.2	57.7	54.0	53.2
3-4 persons	22.5	24.0	24.0	25.1	26.1	26.2
5-9 persons	9.6	10.5	10.9	11.7	13.2	13.4
10-49 persons	3.7	4.1	4.6	5.1	6.3	6.6
50 persons or more	0.3	0.3	0.4	0.4	0.5	0.5
Breakdown by business category (%)						
Miscellaneous goods	0.2	0.2	0.2	0.2	0.2	0.3
Textiles, clothing and accessories	13.8	14.2	14.1	14.1	14.6	15.1
Foodstuff and beverages	48.3	43.9	42.1	41.2	40.4	39.1
Automobiles and bicycles	4.0	4.4	4.9	5.2	5.5	5.9
Furniture, furnishings and fixtures	10.6	10.9	11.0	10.6	10.3	9.9
Other stores	23.1	26.4	27.6	28.7	29.0	29.6
Breakdown by organizational form (%)						
Incorporated stores	16.1	22.8	25.3	27.6	31.1	35.5
Individually owned stores	83.9	77.2	74.7	72.4	88.9	64.5
Individually owned stores without regular employees	73.8	56.4	58.8	54.5	41.4	42.9

Source: Kikkawa and Takaoka, 1998: 106.

According to Kikkawa and Takaoka (1998), the explanation for the decline lies in intra-industry competitive dynamics. The period from 1982 to 1991 saw steady changes in the numbers for the following retail formats (see Table 28):

- The number of household grocery supermarkets²⁸ increased by 150%.
- The number of convenience stores increased by 80%.

²⁸ When discussing supermarkets in Japan, it is important to bear in mind that “unlike the original connotation of the term ‘supermarket’, which means a grocery supermarket, big stores such as Daiei or Itoh Yokado, usually regarded in Japan as typical supermarkets, when classified in terms of business operations are closer to department stores than to supermarkets.” (Kikkawa and Takaoka, 1998: 108)

- The number of general merchandising stores rose by 28%, while grocery supermarkets increased by 19%.
- The number of other supermarkets grew by 15%.
- The number of clothing superstores increased by 2%.
- The number of department stores decreased by 1%, while the number of ordinary retail stores decreased by 10%.

Table 28: Retail stores in Japan according to business category, 1982-1991

Year	1982	1985	Growth in % compared to previous year	1988	Growth in % compared to previous year	1991	Growth in % 1982 - 1991
Department stores	461	428	-7%	433	1%	455	-1%
General merchandising stores	1'507	1'634	8%	1'851	13%	1'924	28%
Clothing supermarkets	606	520	-14%	571	10%	618	2%
Grocery supermarkets	4'358	4'707	8%	4'877	4%	5'185	19%
Household goods supermarkets	531	646	22%	949	47%	1'327	150%
Convenience stores	23'235	29'236	26%	34'550	18%	41'847	80%
Other supermarkets	58'777	59'643	1%	53'834	-10%	67'473	15%
Ordinary retail stores	1'631'990	1'531'820	-6%	1'522'587	-1%	1'472'394	-10%

Source: Based on the Ministry of International Trade and Industry, Statistical Table on Commerce, various annual issues; in Takaoka, 1999b: 8.

Of all of these changes associated with different retail formats, it was the increase in the number of grocery supermarkets and convenience stores that drove many of the small grocery stores out of business because they were able to establish competitive advantage over small retailers in handling perishable goods (see Kikkawa and Takaoka, 1998: 109). According to Takaoka (1999b: 10-11), the competitive advantage of small grocery stores over supermarkets traditionally rested on the former's ability to offer fresh foods. Although the popularity of Western foods increased in the high-growth period in the Japanese economy and the Westernization of food tastes favored the development of big stores and grocery supermarkets, traditional consumption patterns and a preference for freshness prevailed. The strong consumer predilection for fresh food restricted the development of grocery supermarkets because those businesses did not yet have the processes needed to pre-package perishable foods. The supermarket system could only be successful under the pre-packaging system because it centered on self-service operations. Therefore, it was not until the early 1980s that grocery supermarkets began to establish competitive advantage over traditional meat shops, fish stores, and other types of stores by establishing their own system for pre-packaging perishable foods.²⁹

Kansai Supermarket played a central role in developing a pre-packaging system for perishable foods:

“When the All Japanese Supermarkets Association (AJS) held the ‘First Training Session in Hawaii and America’ in 1967, Mr. Kitano, president of Kansai Supermarket, was astonished by the Times Supermarket in Hawaii, where perishable foods were displayed in an open refrigerator. Following this training session, he introduced the open refrigerator into his shops, and at the same time began to develop a new open refrigerator, which would be suitable for perishable foods in Japan. He developed a successful open refrigerator in 1967.” (Takaoka, 1999b: 11)

²⁹ Note that the efficient adoption of the open refrigerator technology requires the retailer to be of a certain size. See also chapter 2.1 and Graph 1.

In addition to open refrigerators, other innovations added to the competitive advantage of supermarkets. Techniques from the automobile and electric industries were introduced, such as that of making efficient use of part-time workers through simplification and standardization. The introduction of the pre-packaging system by Kansai Supermarket was completed in the late 1970s. However, it took almost ten years for the system to spread to other supermarkets throughout Japan. The countrywide adoption of the pre-packaging system was thus one of the underlying causes of the 1985 shock.

Another underlying cause was the growth of convenience stores in the 1970s and 1980s, which affected mostly small retailers of fruits and vegetables, foods and household goods, and books and stationery (see Takaoka, 1999b: 13).

The growth of convenience stores was enabled through the spread of the pre-packaging system and a favorable consumer environment during this period. In particular, the increase in preference for instant consumption options nurtured the rapid growth of convenience stores. Convenience stores fulfilled both the need for accessibility, which had previously been satisfied by traditional small retailers, and the need for a variety of goods, which had previously been satisfied by large retailers like supermarkets. Traditional small retailers competed directly with convenience stores but could not match the convenience stores in terms of variety of goods and/or hours of operation (see Takaoka, 1999b: 13). In addition, we would assume that existing owners of small-sized food stores opened considerable numbers of rapidly growing convenience stores and beverage stores, thereby switching to a more lucrative form of business (see Kikkawa and Takaoka, 1998: 109).

In summary, the initial decline in the number of small retailers was caused not by changes in the regulatory environment (*legislation*) but instead by technological innovations (*technology*) and changing consumption patterns (*shopping habits*). Both factors worked against small traditional grocery retail shops and in favor of grocery supermarkets and convenience stores.

5.3 The increase in intermediate wholesalers between 1994 and 2002 and the issue of direct sourcing

In this chapter, we address the increase in the number of intermediary wholesalers and outline possible arguments that speak for and against an increase in direct sourcing. We start with the issue of direct sourcing.

5.3.1 The question of direct sourcing

It is assumed that direct sourcing is positively correlated with the number of large retailers because large retailers, by virtue of their size, have the power to force manufacturers to supply them directly (see Davies and Itou, 2001: 84-85). Therefore, an increase in the number of large retailers in Japan should lead to more direct sourcing between retailers and manufacturers.

The biggest hurdle in addressing this issue is the fact that no reliable quantitative data exist on direct sourcing in Japan. We therefore approach this question by reviewing the history of direct sourcing in Japan. An historical approach helps us to understand which forces played a part in producing currently existing network structures (see Kikkawa and Takaoka, 1998).

Direct sourcing is usually marketed as a new, Western concept in Japan. It is, however, not new to Japan:

- In 1963, 92% of all supermarkets that participated in a survey conducted by the MITI and the Japanese Chamber of Commerce and Industry indicated that they sourced exclusively through wholesalers. The other 8% sourced directly from manufacturers, whether entirely or in part (see Takaoka, 1999a: 15).
- In the same year, the Osaka Chamber of Commerce and Industry conducted a study involving 54 supermarkets. Overall, 42 of the supermarkets responded that over 60% of all goods were sourced via wholesalers. It is unclear whether the remaining 40% sourced only part or all of their goods directly from the manufacturer (see Takaoka, 1999a: 15).
- Takaoka (1999a) concluded that between 1968 and 1973, a small number of Japanese supermarkets started sourcing less from secondary wholesalers and

regional wholesalers and increased direct sourcing from manufacturers. Out of 38 supermarkets, only 17 (that is, less than 50%) sourced less from primary wholesalers, and only eight supermarkets sourced more than 50% directly from manufacturers; notably, no supermarket sourced all products directly from manufacturers (see Takaoka, 1999a: 15).

- Takaoka (1999b) analyzed six supermarkets with respect to where and how they sourced selected processed food products in 1973 and 1980. Her findings are as follows:
 - In 1973, products such as processed cheese, mayonnaise, cooking oil, instant ramen, and instant coffee were sourced via wholesalers.
 - In 1980, except in the case of one supermarket that sourced these five products directly from the manufacturer, sourcing through wholesalers remained common.

Direct sourcing remained a limited phenomenon, and the so-called “distribution revolution” that theorists had predicted failed to materialize (see Takaoka, 1999a: 17). When the Large-Scale Retail Stores Law was revised at the beginning of the 1990s, it was not the first time that a “distribution revolution” was anticipated. “Distribution revolutions” had already been predicted twice when two large retail formats (namely, department stores and supermarkets) expanded. The “distribution revolutions” never took place, and in the next section, we examine why.

5.3.1.1 The expansion of department stores

The first time a “distribution revolution” leading to disintermediation was anticipated, these expectations arose following the expansion of department stores in the 1920s and after World War II.

Toward the end of World War I, department stores such as Mitsukoshi, Daimaru, Matsuzakaya, Shirokiya, Matsuya, and Takashimaya expanded. Regional department stores appeared. It was predicted that the expansion of department stores would revolutionize the distribution structure and change both traditional trading practices and trading routes: for example, by weakening the prominent position of wholesalers, as

had already occurred in the United States. However, this did not occur. Department stores continued to rely on wholesalers and had no intention of “revolutionizing” their methods of sourcing products (see Tajima, 2004: 165). According to Fukami (1953), competition between department stores and independent, small retail stores became fiercer and developed into a social problem. The government formulated a Department Store Law (see chapter 3.2) to protect small shop owners. Department stores refrained from aggressive trading methods such as conducting frequent bargain sales, opening circuit stores in rural towns, or establishing too many branches (see Fukami, 1953: 42).

The Japanese postwar economy provided a favorable business environment for Japan’s department stores. One of the most important factors was the so-called “Westernization of lifestyle,” which translated into a wider acceptance of Western-style and ready-made clothing and into opportunities for growth (see Takaoka, 1997a: 10). Department stores played a major role in internationalizing Japan by introducing and disseminating foreign merchandise throughout the country (see Creighton, 1991: 678).

As in the prewar period, expanding department stores did not alter their sourcing processes but instead continued to rely on wholesalers. They did so not because they wished to preserve familiar practices but rather because they lacked the managerial resources (i.e., know-how, manpower, and/or financial resources) to do so:

“The personnel and financial resources available during the reconstruction period, however, were insufficient to the task of improving either the reputation or the stores themselves. It was particularly difficult to find clerks capable of dealing with the newly popular Western products. Various policy constraints further bedeviled stores as they sought funds for renovating or rebuilding their stores in convenient locations. Ultimately, department stores did manage to outcompete other types of retail stores by carrying better assortments of clothing, thanks to the fact that they were able to develop vertical relationships with suppliers, which helped to make up for their shortages in human and financial resources.” (Takaoka, 1997a: 10).

One result of these vertical relationships was the development and/or wider use of certain trade practices, later identified by Japan’s trade partners as informal barriers to trade with Japan. The evolution of these trade practices can be explained by analyzing

how managerial resources were distributed among channel members. A typical trade practice that served to mitigate department store shortages in managerial resources after World War II was that of returning unsold goods (*henpin*) (see chapter 2.2.3).

The practice of *henpin* had already existed to a limited extent in prewar Japan, but it became more extensive in the postwar period as a means of addressing managerial shortages. In the prewar version of the system of returning unsold goods, both parties shared the risks involved in accordance with a certain agreed-upon rule. However, the postwar system was not supported by any rule explicitly stipulating how the risks should be shared; i.e., the system was non-institutionalized. The JFTC intervened because of the non-institutionalized character of the system and caused a shift from *kaitori shiire* (upfront purchasing) to *itaku shiire* (consignment purchases).³⁰ The suppliers welcomed the institutionalization of the transaction rules, even though consignment purchases were consequently associated with greater risk and were less attractive than upfront purchases. They accepted the disadvantages because dealing with department stores justified making certain concessions. Also, the practice of returning unsold goods was prone to be used in a very opportunistic way and, if left unchecked, could threaten their own operations (see Kikkawa and Takaoka, 1998: 114).

While the system of consignment purchases addressed the managerial shortages at department stores in the short run, its long-term effect was to tip the balance of bargaining power in the transactions between department stores and suppliers in favor of the latter. From the point of view of the department store, the profit-to-sales ratios of department stores declined because goods purchased by *kaitori shiire* generally led to higher mark-up rates for department stores and merchandise expertise deteriorated, but department store risk was also reduced.

From the point of view of the supplier, to reduce the risk associated with consignment

³⁰ There are three methods of purchasing goods: (1) *Kaitori shiire* (buy-up purchases): The department store bears all the risk for the goods once it purchases them. (2) *Itaku shiire* (consignment purchases): Only the goods sold are treated as having been purchased, and any risk of damages or losses that may arise after the inspection of the goods upon their receipt by the purchasing clerk are borne entirely by the department store. (3) *Uriage shiire* (purchases of goods once sold): Only the goods sold are treated as having been purchased, and any risk of damages or losses that may arise after the inspection of the goods upon their receipt by the purchasing clerk are borne entirely by the supplier.

purchase arrangements, suppliers dispatched their salespersons to department stores. Large department stores were happy to rely on these employees; they were reluctant to increase the number of employees due to labor disputes and difficulty of laying off excess employees (see Fukami, 1953: 48-49).

Through the dispatched salespersons, the suppliers strengthened their position and acquired expertise in closely following and anticipating consumer trends. In this way, they gradually gained control of the sales operations on the floors of department stores (see Kikkawa and Takaoka, 1998: 114).

Department stores that came into existence after the war suffered even more seriously from shortages in managerial resources. They had to address these shortages by depending far more extensively on the practice of consignment purchasing and the dispatch of salespeople (see Kikkawa and Takaoka, 1998: 115).

Even as late as the 1990s, some department stores had failed to introduce the buyer function responsible for selecting merchandise and tracking the salability of the merchandise (see Sternquist and Ogawa, 1993: 151). *The Economist* (2000) explains this fact as follows:

“Ironically, the biggest problem facing Japanese department stores is that they have never really been retailers, and so have few retailing skills. Unlike counterparts in America or Europe, they have traditionally acted more like property developers or shopping-mall operators, earning most of their revenue by renting out space to tenants in return for a small slice of their profits. Thus, tenants and middlemen often controlled design and pricing strategies.”

In summary, department stores were able to expand their businesses after World War II by relying on wholesalers for financial and human resources: i.e., consignment purchases and dispatched salespersons that were able to deal with newly Western products. The trade practices that developed between department stores and their suppliers after the war, especially *henpin*, led even large department-store chains to use wholesalers exclusively as their source of supply (see Dowd, 1959: 261-262). Through consignment purchases, suppliers gradually gained control of sales operations and gained expertise in following and anticipating consumer trends.

5.3.1.2 The introduction of supermarkets

The second innovation in the retail market that was expected to trigger a “distribution revolution” was the introduction of supermarkets.

Supermarkets expanded in Japan in the 1960s. They focused on high volume, low margin, and high turnover, characteristics associated with American supermarkets and discount stores. Although they carried a broad line of merchandise, including food, soft goods, household goods, kitchen utensils, and consumer durables, they tended to concentrate on high-volume standard items within each merchandise category. Japanese supermarkets offered only a limited range of services and pursued an aggressive promotion policy. Most were operated on a self-service basis (see Yoshino, 1971: 132-133).

The factors that promoted the growth of supermarkets included the emergence of a mass consumer market, rapidly rising consumer expectations, the emergence of large-scale manufacturing firms that could supply large quantities of merchandise of consistent quality, and aggressive marketing strategies (see Yoshino, 1971: 139).

The reaction of large manufacturers to the emergent supermarkets varied widely. Some manufacturers initially refused to sell to them, especially to those who failed to accept the manufacturer’s suggested retail price (MSRP). However, recognizing their growing importance, manufacturers soon normalized their relations with supermarkets. Not surprisingly, traditional retailers and wholesalers feared that the new retail format would drive them out of business.

An imminent “distribution revolution” was again proclaimed at this point. A book by Hayashi Shūji called *Ryūtsū kakumei (The Distribution Revolution)* was published in 1962 and became a national bestseller. At the time when the share of large-scale supermarkets was growing rapidly in the Japanese grocery retailing sector, Hayashi (1962) claimed that the role of wholesalers in the distribution system would dramatically decrease in response to the increasing trading power of large-scale retailers (see Azuma and Fernie, 2001: 283). He stressed two points. First, the development of supermarkets would be accompanied by retailers’ expanding their store size, thereby greatly decreasing the existence of small retailers. Second, the mass production and sales system would result in the elimination of wholesalers and lead to a

drastic reduction in the number of distributors (see Takaoka, 1999b: 9). Yoshino (1971: 157) expected a similar development and wrote that mass merchandising firms were attempting to bypass wholesalers and deal directly with large manufacturers, sometimes out of sheer necessity, because wholesalers were often not capable of meeting the large demands of the mass-merchandising firms. The cost savings generated would give large retailers a competitive edge over their smaller competitors.

The actual events that occurred did not match these predictions. Contrary to all predictions, the expansion of neither department stores nor supermarkets caused a “distribution revolution.” Direct sourcing remained a limited phenomenon. Despite their size, both department stores and supermarkets continued to rely on wholesalers and sourced their goods through a multi-stage distribution system as small retailers did.

The question of why these businesses followed a pattern of business behavior that contradicted the predictions made is addressed in the following chapter.

5.3.1.3 The role of secondary wholesalers in the 1960s

According to Meyer-Ohle (1995) and Takaoka (1999a), supermarkets continued to rely on wholesalers for the following two reasons.

- **Consistency of supply:** Supermarkets focused on the expansion of their branch networks and were greatly concerned about having a constant, adequate supply of products so as to maximize returns from the expanding economy and consumer spending. They abstained from setting up their own distributional networks and from circumventing the wholesale framework to avoid conflicts with the manufacturers and their designated wholesalers, which might have jeopardized the constant supply of products to their branches (see Meyer-Ohle, 1995: 175).
- **Dependence on branded goods:** Supermarkets competed on branded goods and therefore needed to offer branded goods from as many manufacturers as possible. Good relationships with manufacturers of branded goods were thus indispensable. Only by constantly offering new products from well-known manufacturers could

supermarkets stay competitive. To reduce the risks associated with the introduction of new products, supermarkets started the practice of rack jobbing.³¹ Because this shifted risk to the suppliers, the supermarkets lost control of pricing and merchandising (see Takaoka, 1999a: 20).

A third explanation focuses on the financing function that wholesalers provided for supermarkets. Within the category of stores labeled “supermarkets,” differences in size were substantial in the 1960s. *The 1965 White Book of Small and Medium Companies* stated that small supermarkets were comparable to average mom-and-pop stores, while large supermarkets were comparable to department stores. During the early expansion of supermarkets in Japan, regardless of their size, supermarkets required significant financial resources. To be able to offer low prices, they needed to buy products in large quantities. To sell significant quantities, they needed to rapidly expand their store count. Their challenge was how to obtain the funding for such rapid expansion. Banks were reluctant to give loans to start-up supermarkets for two reasons. On the one hand, funds were generally scarce after the war. On the other hand, banks perceived the due diligence and monitoring costs per supermarket as being too high (see Takaoka, 1999a: 21). Careful due diligence and monitoring were necessary because the risk that start-up supermarkets would fail was high. In 1968 alone, 478 supermarkets failed, representing 6.8% of the total number of supermarkets. This figure was very high compared to the average bankruptcy rate of 0.74% in the 1960s (see Statistics Bureau of Japan, Chapter 6 “Business Activities” of the Historical Statistics).

Dealing with small and medium-sized supermarkets carried considerable risk. Therefore, both banks and large, primary wholesalers refrained from dealing directly with new supermarkets.

While primary wholesalers refused to do business with supermarkets because of risk concerns, secondary wholesalers did not. As smaller wholesalers, they were often geographically closer to the new supermarkets and could reduce their risk exposure

³¹ Rack jobbing occurs when the supplier secures a number of locations in which it places racks on a consignment basis. The supplier maintains the inventory, moves the merchandise around to attract customers, and manages the bookkeeping.

because they had easier access to information, needed to invest less monitoring effort and cost, and could more easily identify supermarkets with growth potential. By establishing close relationships with promising supermarkets, they were able not only to constantly monitor supermarket performance and development but also to eventually profit from supermarket growth and expand themselves. Secondary wholesalers secured a constant supply of merchandise and provided the funds necessary for the rapid expansion of supermarkets, as Takaoka (1999a) writes:

“The vertical fund supplementation mechanism between the supermarkets and the wholesalers evolved around the axis of the wholesalers’ function of financing. Supermarkets at this time were under pressure because they needed to maximize the benefits of chain operations, but they did not have sufficient funds. Of great significance in overcoming this shortage were the ‘turnover variance funds’ resulting from the differences between the accounts payable turnover and the merchandise turnover. The source of these funds was none other than the wholesalers. “ (Takaoka, 1999a: Summary).

Thus, secondary wholesalers financed the early stage of supermarket development, during which time supermarkets expanded their store counts by using turnover variance funds (*kaitensashiki*) (see Takaoka, 1999a: 20).³² The relationship between secondary wholesalers and supermarkets evolved around this financing function and was a key reason that the multi-stage distribution system stayed in place (see Takaoka, 1999a: 24).

5.3.1.4 The emergence of convenience stores and their impact on the distribution system

While supermarkets did not have the expected impact, but the emergence of the small-scale store convenience store did reform the Japanese distribution system. 7-Eleven

³² According to a report from the Tōkai Bank, even large supermarkets such as Daiei continued to rely on turnover variance funds in the second half of the high growth period, when they could have received loans from banks or could have issued shares. Daiei, the largest supermarket at that time, only started to look for alternative financing sources in the 1970s.

convenience stores spearheaded this development by adopting and implementing a strategy called “total merchandising.” According to Kunitomo (1997: 885), total merchandising differs significantly from the conventional way in which manufacturers plan, produce, and distribute their products to retailers. The convenience store leads the whole process from product development and production to distribution and consumer sales by cooperating and coordinating with both manufacturers and wholesalers. The actors involved share sales information that will help them to jointly design appropriate production and distribution systems. This was necessary because convenience stores competed with traditional mom-and-pop stores in terms of their assortment of goods. In contrast to the traditional mom-and-pop store, however, the convenience store provided an ample assortment of goods within the limited sales area of a small store and targeted a different group, namely young men and women who were fickle in their tastes. To respond to these customers’ needs, it was necessary to constantly introduce new products and eliminate slow-selling items. Approximately 70% of all Seven-Eleven lines are replaced within a year (see Kunitomo, 1997: 885).

Providing an adequate assortment of goods in small convenience stores required innovations on the supplier side. Frequent, small deliveries of different goods from various suppliers are costly, and under the traditional distribution system, convenience stores would have had to deal with a large number of wholesalers because each manufacturer relied on a limited number of wholesalers to handle its products and each wholesaler often chose a second or third wholesaler to deliver the goods that they handled. Seven-Eleven introduced a new system. Goods from different suppliers were distributed in mixed deliveries made by the same vehicle, and this resulted in a reduction in the number of deliveries (see Kunitomo, 1997: 887; Takaoka, 1999b: 14-15).

Additional innovations on the supplier side included the following:

- **Small unit deliveries:** The merchandise space of a 7-Eleven convenience store is approximately 100 m². Each store carries 2’700 to 2’800 items, of which 70% are replaced with new products every year. Instead of ordering a whole carton for which the store has no storage space, a small-unit ordering and delivery system is used that replaces the conventional ordering system.

- **Combined delivery system:** The combined delivery system utilizes temperature-controlled vehicles to carry different kinds of items. Products are divided into four different temperature zones: namely, frozen foods (-20°C), chilled foods (5°C), hot foods (20°C), and processed foods (room temperature). The temperature zone determines the frequency of delivery. Hot foods, for example, are delivered three times a day at the peak purchase times of breakfast, lunch, and dinner (see Kunitomo, 1997: 887-889).

Convenience stores were new to Japan when the first Seven-Eleven store was built in Tokyo in 1974 (see Kunitomo, 1997: 887). When Itō-Yōkadō, Seven-Eleven's parent company, outlined the new demands to be levied on its suppliers (such as frequent, just-in-time delivery of goods from various suppliers in small quantities), the opposition among wholesalers was strong. In the end, however, the wholesalers complied, even though this meant losses in the first two to three years of collaboration with the new convenience stores. According to Meyer-Ohle (1995: 177), they did so because they feared losing business with Seven-Eleven's parent company, Itō-Yōkadō, a top 20 retailer in terms of sales at that time. Moreover, with the rapid increase in the number of convenience stores, the wholesaler started to benefit as well.³³

5.3.1.5 The role of wholesalers in the 1990s

The situation in the 1990s exhibited interesting parallels to that of the 1960s. In both the 1960s and the 1990s, an increase in the number of large stores was expected to shorten the distribution channel and lead to disintermediation.

In the 1960s, supermarkets sourced via wholesalers because they were eager to capitalize on the booming economy and thus aggressively expand their businesses. Secondary wholesalers funded that expansion. In addition, supermarkets competed on branded goods and wanted to remain on good terms with manufacturers, for which reason they continued to source through the wholesale channels designated by their key

³³ Itō-Yōkadō operated 22 general supermarkets in 1971. In terms of sales, Itō-Yōkadō ranked 17th among the Japanese retailers.

manufacturers. Direct supply remained a limited phenomenon.

In the 1980s, banks rather than wholesalers funded the aggressive expansion of store footprints to meet the increasing consumer demand for more products during the bubble economy. Eventually the economic bubble burst at the beginning of the 1990s, and consumer demand decreased; as a result, sales space productivity fell. Retailers were trapped because servicing the bank loans was tied to increasing sales.³⁴ They tried to increase sales by increasing sales space (see Table 29), which increased the loan burden even more, and hoped that consumer confidence would eventually return (see Dawson and Larke, 2004: 80ff).

Table 29: Sales space for Japan's largest retailers in 1991, 1995, and 1999

Retailer	Sales space (m2)			Change in %	
	1991	1995	1999	1991-1995	1995-1999
Daiei	1'612'770	3'825'370	2'467'076	137.2	-35.5
Ito Yokado	1'106'930	1'357'785	1'779'498	22.7	31.1
Jusco	895'946	1'367'878	2'554'000	52.7	86.7
MYCAL	831'300	1'073'547	1'376'780	29.1	28.2
Takashimaya	244'996	473'207	527'898	93.1	11.6
Seiyu	915'458	1'076'382	1'118'798	17.6	3.9
Uny	627'572	856'402	1'077'720	36.5	25.8
Mitsukoshi	364'401	390'360	367'235	7.1	-5.9
Seibu Department stores	421'248	453'668	494'574	7.7	9.0
Marui	370'901	409'536	447'275	10.4	9.2
All department stores	6'377'047	7'124'072	7'290'180	5.8	2.3
All supermarkets*	9'524'750	11'394'322	12'753'392	19.6	11.9

*General merchandise chain stores only

Source: Dawson and Larke, 2004: 82.

³⁴ During the bubble era, many of these retail conglomerates borrowed from banks using land as collateral. After land prices had gone down and the economy had entered a recession, they were unable to pay back these loans.

Consumer confidence, however, weakened further through the 1990s; retail spending per household fell, as did sales space productivity. The loan burden of the retailers grew to massive proportions (see Table 30). As Dawson and Larke (2000) have noted,

“The increase in floor space during the 1990s was a result of a strategy aimed at servicing the debt burden in the short term in the hope of increased consumer spending in the long term. The increase in consumer spending has not materialized and innovation has not been applied to reverse the decline in asset, including space productivity. As a result the strategy of expansion of sales space has been a spectacular failure.” (Dawson and Larke, 2004: 82)

Table 30 shows the change in profits for the 10 largest retail firms during the 1990s together with the amount of debt in 1998.³⁵

³⁵ Sales and space figures are shown for the core business only, and these statistics must therefore be interpreted with care because retailers undertook considerable diversification activities and grew into large conglomerate corporations. The groupings provided convenient ways to move profits and losses within a group to minimize corporate taxes. The majority of these subsidiaries were not included in the main accounts until 2001, when new accounting procedures required companies to publish consolidated accounts so that all debt had to be fully reported.

Table 30: The largest 10 retail firms as ranked by sales in 1991 and 1999

Retailer	Sales			Pre-tax profit		Interest bearing debt 1998 (in billion JPY)
	1991	1999	Change in % 1991-1999	1999	Change in % 1991-1999	
Daiei	2'025'920	2'204'823	8.83	1'147	-95.80	655'797
Ito Yokado	1'459'590	1'508'910	3.38	51'081	-47.40	-
Jusco	1'041'337	1'422'444	36.60	23'844	-19.40	133'314
MYCAL	767'128	1'081'022	40.92	3'244	-88.90	289'246
Takashimaya	8'429'781	1'021'037	21.12	1'178	-91.20	175'479
Seiyu	1'094'978	875'369	-20.06	6'341	-60.40	310'493
Uny	555'826	773'987	39.25	12'796	-26.50	118'889
Mitsukoshi	876'618	675'748	-22.91	6'108	-44.40	147'421
Seibu Department stores	916'915	588'779	-35.79	3'854	n.a.	437'500
Marui	569'070	480'881	-15.50	28'628	-50.10	131'812
Largest 100 firms	25'022'596	27'190'480	8.66	-	-	-

Source: Dawson and Larke, 2004: 82.

Most retailers were able to stay in business through the 1990s because of the attitudes that the banks took with respect to these debts and because of the effect that these retailers' failure would have had on the Japanese banking sector (see Dawson and Larke, 2004: 82).

Dawson and Larke (2004) reported that the use of consignment sales and supplier-employed sales staff in department stores increased in the 1990s as retailers sought support from their suppliers and tried to reduce costs associated with directly paid employees. In 1999, some 3.6% of retail employees were employed by suppliers. Department stores had more than 37% of their staff employed by suppliers. For example, the Takashimaya Department Store, which opened at Nagoya Station in March 1999 with a sales area of 55'000 m², had approximately 100 staff members employed by Takashimaya when it opened; the rest came from the suppliers and the owner of the site, JR Tōkaidō (see Dawson and Larke, 2004: 81).

Table 31 provides an overview of the salespeople who were dispatched to selected

Japanese department stores in 1988; note that this was before the bubble burst.

Table 31: Salespersons dispatched to selected Japanese department stores, 1988

Department store	Ratio (%)	Number (persons)
1. Keihin	235.1	1'380
2. Iyotetsu Sogo	178.5	1'294
3. Chiba Mitsukoshi	159.8	1'200
4. Kurosaki Sogo	151.5	1'198
5. Tokyu	148.3	7'644
6. Chubu Kintetsu	133.5	940
7. Chiba Sogo	121.0	1'483
8. Marui Imai	116.7	2'500
9. Hiroshima Sogo	109.0	1'380
10. Tenmaya	107.0	1'814
11. Fujisaki	102.2	830
12. Seibu	101.3	20'302
13. Odakyu	78.7	2'042
14. Hakata Daimaru	70.6	720
15. Yamagataya	64.1	900

Source: Ito and Maruyama, 1990: 18.

Retailers in particular depended on wholesalers for order processing due to a sharp increase in the number of products handled per retailer. Jetro (2004: 11) reported that Japanese department stores are very similar in terms of the goods stocked. When sales at department stores stagnated, many department stores increased their product ranges to attract more customers. According to Maruyama (2004: 39-40), the number of products stocked by retailers increased dramatically. Large urban department stores carried between 1.5 and 2 million product items, while general merchandise stores (GMS) carried between 300'000 and 400'000 items. The household products of one Japanese manufacturer, on the other hand, included 100 items in 1975 and ballooned to more than 300 items by 1980 and 500 items by 1985. In 1980, there were 600 items in the beer market (400 domestic and 200 imports), 400 shampoo/rinse items, 211 types of televisions, and 127 types of washing machines.

According to *The Economist* (1991/1992), approximately 10'000 new products are

launched every year in Japan. Retailers readily accept the need to introduce a large number of new products because there is little risk in doing so.

This trend of launching a large number of new products is not confined to Japan. A similar trend is apparent in the United States. For example, in the United States in 1970, the number of new product items introduced was 1'365. A single store typically carried 7'800 items. By 1985, the number of new items had risen to 7'330, and the number of store items had increased to 12'459. By 1990, these numbers had risen to 13'244 for new products and 30'000 for store items (see Maruyama, 2004: 40).

In the United States, expansion of the number of product items led to the emergence of very large retail stores and direct sourcing. In Japan, because of the limited availability of retail store space, stores had to find other ways to cope with this development. Like convenience stores, large retailers started ordering their products in increasingly smaller units from the 1980s onwards, with units ranging from the conventional case (or dozen) to the half-case and even down to two or three individual units of a particular product. As a result of these smaller orders, delivery frequency increased from once per week to twice per week or more; sometimes deliveries were even made daily (see Maruyama, 2004: 40; Jung, 2000: 2).

Competition on product selection rather than on price would explain why only some of the largest retailers took advantage of the new regulatory environment by opening large numbers of new stores. Four of the largest retailers chose to rebuild or relocate existing stores. According to Davies and Itou (2001, 92-93), there was an increase in the average store size among large retailers, but there was less of an increase in the total number of large stores. Retailers sought to benefit from an increase in scope (that is, obtaining a wider range of products at the same location by increasing store size) rather than scale (i.e., generating more purchasing power from greater sales of the same goods by increasing store counts).

5.3.2 The increase in the number of intermediate wholesalers

Our final open question concerns the increase in the number of intermediate wholesalers between 1994 and 2002.

While the increase in the number of intermediate wholesalers went almost unnoticed,

the decrease in the number of other wholesaler categories has been widely discussed. Interestingly, the decrease in the number of wholesalers is seldom attributed to changes in the regulatory environment. Instead, it is attributed to the sluggish economy and the need for large retailers to reduce the number of wholesalers that they source from for efficiency reasons.

METI (2004) has suggested that the general decline in the number of wholesalers in the 1990s is due to the reduction in trade volume (in terms of sales channeled through the distribution system) that occurred after the economic bubble burst. In 2002, annual total sales of consumer goods in wholesale trade reached JPY 163.6 trillion, down 18.1% from the 1997 survey. Between 1994 and 1997, total sales decreased from JPY 195.6 trillion to JPY 182.1 trillion, yielding a decrease of 6.9%. Between 1994 and 2002, total sales decreased by 16.4% (see METI, 2004: 22).

As a result, large retailers cut costs by reducing the number of wholesalers that they contracted with, but they did not increase direct sourcing (see Maruyama, 2004: 36-37; *The Economist*, 2004). This cost cutting led to a series of mergers and acquisitions within the wholesale industry:

- In the processed food sector, Itōchū Shokuhin was formed by a merger between two companies in the Itōchū Group in 1996. Meanwhile, Sanyū Koami was established in 2000 via a merger between Sanyū Shokuhin of the Mitsui Bussan Group and the alcoholic beverage wholesaler Koami.
- In the frozen and refrigerated foods industry, Itōchū Corporation merged with Yuki-Jirushi Access in 2004. The latter company itself was formed through a merger of five wholesalers affiliated with Snow Brand Milk Products. In 2003, a subsidiary of Ryōshoku, a Mitsubishi Group company, merged with Yukiwa, a wholesale subsidiary of Nichirei.
- In the alcoholic beverage sector, large wholesalers have actively engaged in merger and acquisition activities with regional alcoholic beverage wholesalers. The leading food wholesaler Kokubu integrated 20 regional alcoholic beverage wholesalers across the country in 1998 and 1999. Ryōshoku has been expanding into the alcoholic beverage division since 2000 through mergers and capital tie-ups with alcoholic beverage wholesalers (see Maruyama, 2004: 36-37).

From the point of view of the wholesalers, carrying a broad range of products is linked with higher costs and with a large number of newly launched products. This carries considerable risk unless a specific strategy is adopted. Wholesalers must carry rather specialized assortments to reduce the costs associated with carrying broad inventories and must develop expertise in a specialized merchandise line. If a customer orders merchandise that the wholesaler does not carry, the wholesaler can call on another wholesaler to supply him/her with the requested products. In this manner, wholesalers can sell broad merchandise lines, even though they may carry limited ranges in their physical inventory (see Maruyama, 2004: 36-37).

While such a strategy might help to control the inventory costs of an individual wholesaler, the number of horizontal transactions in the channel increases, as do the potential total distribution costs associated with a product (see Pirog III and Lancioni, 1996: 56). Here, one must keep in mind that it is not simply the number of transactions but also the magnitude of each margin along the way that affects the final costs of distribution. Note that according to Coughlan and Lal (1992: 210), retail price and channel length are not necessarily correlated, and having many more middleman levels than just one can be profit maximizing.

As Pirog III and Lancioni (1996: 58) explain,

“Numerous small margins may have a much smaller impact than a single hefty mark-up. While economies of scale in distribution can create cost reductions via fewer transactions, economies of scale can also create cost reductions via more transactions.”

They argued that scale economies could be generated among many co-operating establishments at a particular channel level, resulting in lower overall distribution costs (see Pirog III and Lancioni, 1996: 58). To support their argument, they made a rare comparison of distribution cost structures in the United States and Japan.³⁶ Table 32 shows Japan’s distributed cost structures for consumer goods. Each row lists how much

³⁶ Distribution cost structure refers to how much of the end user’s dollar is allocated to the various levels of the channel (i.e., producer, wholesaler, retailer, and logistics specialist).

of a consumer's dollar goes to the producer and to distributors. The last row labeled "Total" shows the average of the 18 rows. Note that 64.21% of each consumer's yen goes to the producer, while 35.79% goes to distributors. This latter figure of 35.79% breaks down further, with 8.13% going to wholesalers, 25.83% going to retailers, and 1.83% going to transportation.

Table 32 also shows considerable variance in cost structures across product categories. Only apparel and leather goods have distribution costs of more than 50%. For the remaining categories, distribution costs range from 25% to 48%.

Table 32: The distribution cost structure for consumer goods in Japan

Consumer good	Producer (%)	Wholesale (%)	Retail (%)	Transportation (%)	Total distribution (%)
Agricultural products	55.23	13.81	28.53	2.43	44.77
Food products	72.09	5.94	19.81	2.16	27.91
Textiles	57.77	10.03	25.86	6.33	42.23
Apparel and leather products	48.71	11.68	38.92	0.69	51.29
Paper and wood products	62.99	8.42	25.21	3.37	37.01
Furniture	55.38	5.55	37.04	2.03	44.62
Publishing	58.84	1.62	38.38	1.16	41.16
Chemical products	52.21	9.42	37.78	0.59	47.79
Petroleum products	62.78	11.33	24.33	1.56	37.22
Rubber and plastic products	51.23	8.04	39.74	0.99	48.77
Glass, clay and stone products	71.80	10.94	12.76	4.50	28.20
Primary metal products	74.96	15.99	7.66	1.38	25.04
Finished metal products	63.56	4.51	31.17	0.75	36.44
Machinery	59.12	5.33	34.90	0.64	40.88
Electrical equipment	68.99	7.47	22.83	0.71	31.01
Transport vehicles	71.05	4.83	23.24	0.88	28.95
Precision instruments	64.37	7.94	26.79	0.90	35.63
Other	70.69	12.13	16.05	1.13	29.31
Total	64.21	8.13	25.83	1.83	35.79

Source: Pirog III and Lancioni, 1996: 60.

Table 33 shows the cost structures for consumer goods in the United States. This table can be read the same way as Table 32. 64.92% of each consumer dollar goes to the producer, while 35.08% goes to distributors. This latter figure of 35.08% breaks down further, with 6.11% going to wholesalers, 27.27% going to retailers, and 1.70% going to transportation.

Table 33: Distribution cost structures for consumer goods in the United States

Consumer good	Producer (%)	Wholesale (%)	Retail (%)	Transportation (%)	Total distribution (%)
Agricultural products	56.34	7.04	28.77	7.85	43.66
Food products	68.15	7.82	22.44	1.59	31.85
Textiles	54.09	4.02	41.31	0.58	45.91
Apparel and leather products	57.25	3.73	38.80	0.22	42.75
Paper and wood products	57.83	3.72	36.55	1.91	42.17
Furniture	57.91	2.11	39.45	0.53	42.09
Publishing	68.20	3.57	26.77	1.46	31.80
Chemical products	59.21	7.02	32.39	1.38	40.79
Petroleum products	75.77	6.86	14.77	2.60	24.23
Rubber and plastic products	50.88	7.31	40.02	1.79	49.12
Glass, clay and stone products	49.53	5.45	43.66	1.36	50.47
Primary metal products	56.84	3.71	36.91	2.54	43.16
Finished metal products	53.44	6.41	39.22	0.93	46.56
Machinery	60.29	8.70	30.54	0.47	39.71
Electrical equipment	60.90	6.96	31.05	1.08	39.10
Transport vehicles	76.90	2.97	17.57	2.56	23.10
Precision instruments	51.27	5.92	42.65	0.15	48.73
Other	54.96	7.44	36.91	0.69	45.04
Total	64.92	6.11	27.27	1.70	35.08

Source: Pirog III and Lancioni, 1996: 60.

In Table 34, the United States values were subcontracted from the Japanese values. The table shows the differences in distribution cost structures for Japan and the United States. Negative numbers indicate that the cost is lower in Japan than in the United States.

The bottom row, for example, shows that distributors in Japan claim more of each consumer dollar with respect to the yen, but the difference is very small (0.71%). Japanese wholesalers claim 2.02% more than their American counterparts, while Japanese retailers receive 1.44% less. Japanese transportation firms obtain more or less the same (0.13%) share as their American counterparts.

Table 34: Differences in distribution cost structures for consumer goods: Japan minus the United States

Consumer good	Producer (%)	Wholesale (%)	Retail (%)	Transportation (%)	Total distribution (%)
Agricultural products	-1.11	6.77	-0.24	-5.42	1.11
Food products	3.94	-1.88	-2.63	0.57	-3.94
Textiles	3.68	6.01	-15.45	5.75	-3.68
Apparel and leather products	-8.54	7.95	0.12	0.47	8.54
Paper and wood products	5.16	4.70	-11.34	1.46	-5.16
Furniture	-2.53	3.44	-2.41	1.50	2.53
Publishing	-9.36	-1.95	11.61	-0.30	9.36
Chemical products	-7.00	2.40	5.39	-0.79	7.00
Petroleum products	-12.99	4.47	9.56	-1.04	12.99
Rubber and plastic products	0.35	0.73	-0.28	-0.80	-0.35
Glass, clay and stone products	22.27	5.49	-30.90	3.14	-22.27
Primary metal products	18.12	12.28	-29.25	-1.16	-18.12
Finished metal products	10.12	-1.90	-8.05	-0.18	-10.12
Machinery	-1.17	-3.37	4.36	0.17	1.17
Electrical equipment	8.09	0.51	-8.22	-0.37	-8.09
Transport vehicles	-5.85	1.86	5.67	-1.68	5.85
Precision instruments	13.10	2.02	-15.86	0.75	-13.10
Other	15.73	4.69	-20.86	0.44	-15.73
Total	-0.71	2.02	-1.44	0.13	0.71

Source: Pirog III and Lancioni, 1996: 61.

Based on these results, Pirog III and Lancioni (1996) concluded that taking all consumer goods into account, the distribution cost differences between Japan and the United States are smaller than the literature suggests.

Returning to the trend of large retailers limiting the number of suppliers, Miwa (2002: 178) argues that this phenomenon should not be overestimated. Miwa cites an industry specialist who explains that even the most rationalized CVS chain shop, holding 800 or 900 food items, does not limit the number of manufacturers from which it buys. It buys

less than 300 or 400 items from the largest supplier and considers any further increase in the concentration of suppliers to be costly.

The total number of final wholesalers that source from wholesalers and sell to retailers declined by about 8% between 1994 and 2002 (see Table 10). Their number decreased by “only” 8% because, despite the growth of large retailers, there remained a large number of medium-sized and small retailers that final wholesalers were able to serve with existing and new services. Small and medium-sized wholesalers cover those areas of the market that are beyond the reach of major wholesalers. This includes supplying small and medium-sized community-based retailers such as local supermarkets, and wholesaling products made by local manufacturers. Supermarkets in Japan stock an unusually large amount of fresh food. Serving local supermarkets requires an intimate understanding of local tastes and of how customers’ tastes vary according to store location and time of day. (see *The Economist*, 1999).

Other services provided to small retailers include merchandising, product development, order receipt networks, sales promotion, purchases on behalf of local retailers, the acquisition and expansion of new channels, information gathering, and communication (see Small and Medium Enterprise Agency, 2005: 142-143).

Final wholesalers also cater to the needs of regionally operating retailers. Jetro (2004) reported that there remain market segments with no national players. In the drugstore market, for example, even the industry-leading chains are still regional, and there are no national players. Similarly, in the home improvement industry, there are no nationwide chains. The industry leaders are all regional chains, although they are morphing into national chains (see Jetro, 2004: 21-23). Japan also still features a large number of department store chains, while in many Western nations, the number of department stores has been reduced until just a few are left. As of July 2003, there were 99 department store operators in Japan. Only 10 out of these 99 operated nationwide, and the same 10 accounted for 57% of total department store sales. The remaining 43% were mainly regional department stores that each focused on their respective prefectural capital (see Jetro, 2004: 10).

The transformation of certain retailers into national chains also explains the formation of national wholesalers:

- Paltac (headquartered in Osaka) merged with 15 regional wholesalers starting in the 1990s and transformed itself into the industry's foremost national wholesaler.
- Daika (headquartered in Hokkaidō), Itoi (headquartered in Nagoya), Sanbic (headquartered in Fukuoka), and Tokukura (headquartered in Tokushima) merged into Arata, a national wholesaler covering all of Japan except Okinawa.

According to METI (2004), the reason for the *increase* in the number of intermediate wholesalers is the same as the reason for the decrease in the number of all other wholesale categories: the sluggish Japanese economy following the burst of the bubble at the beginning of the 1990s, which led to a decline in the value of goods channeled through the distribution system and forced firms to increase efficiency.

- Final wholesalers became intermediate wholesalers because it was financially more rewarding to serve final wholesalers than it was to serve a decreasing number of small retail stores.
- New wholesalers were formed as spin-offs from manufacturers because they were forced to concentrate on their core business for efficiency reasons. Wholesalers that had previously bought from manufacturers and sold to wholesalers (i.e., source wholesalers) were now classified as intermediate wholesalers.
- Wholesalers emerged specializing in buying second-hand goods from individual sellers, thereby serving the growing market for second-hand goods in Japan after the end of the bubble economy.

It is unclear to date which development contributed the most to the increase in the number of intermediate wholesalers.

In addition, the increasing imports of lower-cost overseas products offered new business opportunities for intermediate wholesalers to act as links between importers and final wholesalers. Between 1994 and 2002, the number of direct trade wholesalers to retailers (wholesale level 1.1.2, see Table 10) that sourced from overseas and then sold to retailers increased from 1'435 to 2'030, creating a 41.5% increase, while the number of source wholesalers sourcing from overseas and selling to wholesalers increased from 2'639 to 3'789, creating an increase of 43.6% (see Table 10). The drivers of the increase in imports were the need for retailers to offer products with a

better price-performance ratio (i.e., foreign products or re-imports from Japanese manufacturing sites outside Japan) and the need to offer foreign products that would appeal to the Japanese consumer and also help retailers to differentiate themselves from their competitors.

5.3.3 Summary

Chapter 6.3 opened with two questions: (1) Did the (still moderate) increase in the number of large retailers lead to more direct sourcing? (2) Why did the number of intermediate wholesalers increase after the revision of the statute?

Regarding the first question, we note the belief that by virtue of their size, large retailers would internalize wholesale function and/or shift them to manufacturers, thereby establishing a direct link between retailers and manufacturers. However, we have indicated that it is questionable whether retailers were actually able to so.

We believe that retailers had neither the *power* to force manufacturers to supply them directly nor the necessary *resources* to internalize wholesale functions. Burdened with bank loans as a relic of the bubble economy in the 1980s, when Japanese retailers had aggressively expanded sales footprints to meet consumer demand for more products, these retailers tried to further increase sales in the 1990s by expanding their sales footprints. This in turn only further increased their loan burden and their dependence on manufacturers and goods. Because their financial resources were concentrated on increasing sales and repaying loans, there was little money left over for them to use to assume wholesaler functions:

- The focus on the expansion of sales space required that storage space be minimized, which translated into a need for smaller inventories. Smaller inventories required the frequent and reliable supply of merchandise in accurate, small quantities, which was a requirement that wholesalers had learned to efficiently fulfill upon the emergence of convenience stores.
- The strategy of retailers was to increase sales by offering a broad product selection and regularly introducing new products. Ordering through wholesalers allowed them access to a large number of manufacturers and simultaneously allowed them to keep the number of suppliers that they dealt with at a comparatively low level.

- Retailers also depended on their suppliers for consignment selling, supplier-employed sales staff who would help to minimize labor costs, and merchandising know-how. These practices developed after World War II and led to a distinct distribution of functions between retailers and wholesalers in Japan.

With these findings in mind, we believe it is rather unlikely that direct sourcing increased considerably after the revision of the Large-Scale Retail Stores Law. This question, however, needs further research; no reliable quantitative data addressing it are currently available.

Regarding the second question, we suggest that the increase in the number of intermediate wholesalers has been the outcome of a number of developments that have little to do with the revised statute. The value of goods channeled through the distribution system decreased in the 1990s due to the sluggish economy. In their efforts to cut costs, some manufacturers spun off their distribution division. Final wholesalers became intermediate wholesalers because it was more profitable for them to supply other wholesalers than it was for them to supply small retailers. The market for second-hand products in Japan expanded, and wholesalers began buying such products from individual sellers. An increasing number of lower-cost products were sourced from overseas, offering new opportunities for intermediate wholesalers to purchase from importers. Hence, the decreased values of goods channeled through the system led several businesses to assess their business profile, which in turn led to an increase in intermediate wholesalers.

6 Conclusions

6.1 Key findings

The revision of the Large-Scale Retail Stores Law was expected to ease regulatory constraints on retail store size and unleash the power of a number of social and technological developments (associated changes), resulting in the modernization of Japan's distribution system for consumer goods. Key expectations included the following:

- **More large stores:** The number of large stores was expected to increase because regulatory constraints on size were relaxed.
- **Fewer small stores:** The number of small stores was expected to decline because they were faced with increased competition from large stores and the loss of regulatory protection.
- **Shorter distribution channels:** With the number of large retailers increasing, trade flows between manufacturers and retailers were expected to increasingly include one level of wholesalers only. Wholesale circuitry was predicted to improve.
- **More direct sourcing:** Direct sourcing between manufacturers and retailers was predicted to increase due to retailers' channel power. Large retailers, because of their size, were expected to force manufacturers to supply them directly. In addition, large retailers were not supposed to depend on wholesalers anymore as order placing and processing nodes because of the implementation of inter-firm EDI (electronic data interchange) systems, which linked manufacturers and retailers, and POS (point of sales) systems, which enabled retailers to make the right sourcing decisions based on the analysis of sales-related information gathered by POS systems.
- **Fewer wholesale establishments:** The number of wholesale establishments was expected to decline as a result of the decline in the number of small retailers and because of the existence of shorter distribution channels and more direct sourcing patterns.

The quantitative findings of this study can be summarized as follows:

- **The number of large stores increased.** Based on the statistics obtained for this study, the growth of large retail establishments may be associated with the revision of the statute in question. Thus, this statute appears to have opened more opportunities for large-scale establishments to penetrate the Japanese consumer market. However, while we find a correlation between the revision of the statute and an increase in the number of large stores, the rate of change is found to be relatively small, and the causal relationship between the revision of the statute and the change in the structure of the retail market remains questionable.
- **The number of small traditional retailers declined.** However, we find that the revised statute cannot be identified as the primary reason for the decline in the number of small retailers because the decline had already begun between 1982 and 1985: that is, before the implementation of the revised statute.
- **We were unable to confirm whether wholesale circuitry had improved.** To assess the length of the distribution channels, we used various ratios to determine wholesale circuitry. We found that the ratios are not adequate to determine the internal structure of the wholesale sector. We caution that all ratios are the result of approximate estimation methods and that a definitive statement on wholesale circuitry is therefore impossible.
- **The overall number of wholesalers from all except one category decreased.** We found that the number of wholesalers in all categories but one decreased after the implementation of the revised statute. However, there was a significant increase in the number of intermediate wholesalers, which does not support our research hypothesis.
- **Predictions that direct sourcing would increase could not be quantitatively validated.** An analysis of the development of direct sourcing reveals missing data on the link between manufacturers and retailers. Anecdotal data are available, however, and we decided to study direct trends. Nevertheless, the descriptive data used are associated with a response rate of only 19%, and given this small population, the data may omit extreme values that may alter the trends. Thus, we are unable to quantitatively confirm that developments in direct sourcing were related

to the application of the statute in question.

Below we will discuss the results obtained from our data analysis that do not support our research hypothesis. These include the following:

- (1) The slow rate of change in the number of large retail stores.
- (2) The initiation of a decrease in the number of small retailers prior to the implementation of the revised statute during the years 1982 – 1985.
- (3) The increase in the number intermediate wholesalers during the period studied.
- (4) Developments in direct sourcing.

What follows is more insight into result (1). We have analyzed the revised statute and associated changes in more detail and have found that there are still a number of factors that limit the expansion of large stores. Based on the revised statute, although procedures were simplified and retailers with floor space up to 1'000 m² were no longer subject to the regulations, restrictions on the expansion of large retailers remained in place even after the revision. In 2000, a new law replacing the Large-Scale Retail Stores Law went into effect. While the new statute no longer explicitly protects small retailers, it is understood to constrain large retailers wishing to expand based on environmental concerns (*legislation*).

In addition, some observers argue that, because large retailers in Japan compete on product selection rather than price, there was an increase in the average store size operated by large retailers but less of an increase in the total number of large stores. Large retailers sought to benefit from an increase in scope (i.e., obtaining a wider range of products at the same location by increasing store size) rather than scale (i.e., generating more purchasing power from increased sales of the same goods by increasing store counts). This might have contributed to the moderate increase in the number of large retail stores.

With regard to the associated changes, our analysis produced the following findings:

Distributional IT: There were rapid increases in the diffusion rate of product bar codes and in the number of retailers equipped with POS systems, reflecting the explosion of the number of product items moving through the distribution networks. The adoption of inter-firm EDI systems, however, was limited (*technology*). Possible explanations for

the limited adoption of inter-firm EDI are as follows.

- **Government interference obstructed standardization:** It has been argued that governments should help to standardize information management because telecommunication networks and computerized information systems are part of the social infrastructure of a country. By reducing the costs of system construction, communication and information management to private firms, a government can promote the development and use of IT. However, the policy of prioritizing the fair treatment of all industry members, which is one that is reportedly often adopted by the Japanese government, served to protect the interests of weaker members and sets the target speed of industry-wide system development at a rather low level. In this case, frontrunners were asked to move at a slower pace and, expecting the government to intervene, tended to postpone their own R&D activities because government interference naturally serves to eliminate any first-mover advantage.
- **The costs and conflicts of interest among the potential parties were too numerous:**
 - **Coordination costs:** The design and adoption of an IT system involves the coordination of a large number of potential participants. Coordination costs increase with the number of participants.
 - **Disclosure of valuable information:** Demand prices for inter-firm systems vary greatly because the value of any information drawn from the system differs among individual firms. The demand price or value of any information depends on the firm's intra-firm system for decision-making and information flow and the firm's business know-how and ability to use this information. Because the coordination of any inter-firm system requires firms to disclose know-how and ideas, their value will fall as the number of firms with access to them rises. This makes cooperation difficult.
 - **Diverse demands on the system:** Demands regarding the type of data to be collected and information to be provided differ greatly among the participants. The type of information that is of value to a firm depends on its products, technology, history, market position, and so on. Expectations vary significantly among firms, and reaching an agreement regarding system

design can consequently be very difficult.

- **Battle for leadership:** The design and function of an inter-firm system will influence the demand price for each firm and spark a battle for leadership in the construction of such a system.
- **The need for ongoing cooperation:** Cooperation and coordination must exist not only during the system's initial construction but also when the system is complete and operational. The experience and business know-how gained will generate new ideas about how to improve the system. Thus, the growth and evolution of both intra-firm and inter-firm dynamics create the need for on-going cooperation.

Private label products: The share of private label products in Japan remained low in international comparison. There are two possible explanations for this; firstly, that brand-consciousness did not decline as much as expected (*shopping behavior*), and secondly, that the share of private label products was low because the retail concentration was low as compared to that of other nations. Discounters selling a limited selection of products (mainly staples) at a very low price contribute to a higher retail concentration. This was clearly not going to occur in Japan, with Japanese retailers competing on product selection rather than price and Japanese consumers preferring fresh foods.

Car ownership: The private car ownership rate remained low in comparison with that of other nations. This might be due to the sluggish economy, limited space for and/or the cost associated with owning a car and parking spots at home. In addition, car owners in Japan shop neither less frequently nor in bulk (*shopping habits*). Shopping by car in Japan is cumbersome because roads are often congested and there are few parking lots. The attractiveness to the Japanese consumer of large stores outside their neighborhoods and outside city centers is limited due to high population density (*geographic environment*).

Larger dwellings: The average dwelling size increased only in non-metropolitan areas. In metropolitan areas, in which almost half the population lives, the average housing size actually decreased in the years studied. More importantly, the relationship between dwelling size and shopping behavior is unclear; there is no real indication that people

who live in larger residences in Japan prefer to shop less and store more surplus products at home (*shopping habits*). Some studies suggest that the number of small retailers is large because the Japanese need to shop frequently because there is so little storage space in Japanese homes. However, this explanation does not fully explain the small size of both consumer non-durable *and* durable retailers, which the former selling goods such as hardware, garden supplies, furniture, and fixtures.

Regarding result (2), we note that the decline in the number of small traditional retailers between 1982 and 1985 was caused by certain retail formats' establishing competitive advantage over the traditional small-scale businesses that had originally enjoyed such an edge. The number of small retailers started to decline once grocery supermarkets had acquired the necessary know-how and technology to pre-package and sell perishable food. Another factor was the proliferation of convenience stores in the 1970s and 1980s, which was facilitated by the spread of the pre-packaging system and the favorable consumer environment during this period. In particular, the popularity of instant consumption nurtured the quick growth of convenience stores. Convenience stores met both the need for accessibility, which had been satisfied by small traditional retailers, and the need for a large selection of goods. Hence, we are able to conclude the initiation of a decrease in the number of small retailers was not caused by changes in the regulatory environment. Technological innovations (*technology*) and changing consumption patterns (*shopping habits*) worked against small traditional grocery retail shops and in favor of supermarkets and convenience stores.

Regarding result (3), we note that the end of Japan's bubble economy decreased the value of goods channeled through the distribution system. This led several channel participants to assess their business profiles, which in turn led to an increase in the number of intermediate wholesalers.

- In their efforts to cut costs, some manufacturers spun off their distribution division. Wholesalers that had previously bought from manufacturers and sold to wholesalers (i.e., source wholesalers) were now classified as intermediate wholesalers.
- Final wholesalers became intermediate wholesalers because it was more profitable for them to supply other wholesalers than it was for them to supply small retailers.
- The market for second-hand products in Japan expanded. Wholesalers buying these

second-hand products from individual sellers were classified as intermediate wholesalers.

- An increasing number of lower-cost products were sourced from overseas, offering new opportunities for intermediate wholesalers to purchase from importers.

Interestingly, the decrease in the number of all other wholesaler categories is generally not attributed to changes in the regulatory environment. One explanation is the reduced trade volume in terms of sales channeled through the system. Some wholesalers were simply driven out of business, while others merged as large retailers cut costs by reducing the number of wholesalers they contracted with in search of greater efficiency. The transformation of regionally operating chains such as department stores or drugstores into national chains contributed further to the wave of mergers and acquisitions.

Regarding result (4), we note that direct sourcing does not appear to have significantly increased after the implementation of the revised Large-Scale Retail Store Law. Large retailers were neither in a position to force manufacturers to supply them directly (*power*), nor did they have the resources necessary (*resources*) to internalize wholesaler functions. In the 1990s, large retailers were burdened with bank loans, a relic of the bubble economy in the 1980s, during which they aggressively had expanded their sales footprints to meet consumer demand for more products. After the bubble burst at the beginning of the 1990s, Japanese retailers tried to further increase sales by further expanding their sales footprints and expanding product selection, which in turn further increased their loan burden and their dependence on a constant flow of new products and manufacturers. Because their financial resources were concentrated on increasing sales and repaying loans, there was little money left for these firms to use to assume the functions performed by wholesalers.

- **Storage and distribution function:** The focus on the expansion of sales space required that storage space be minimized, which translated into a need for smaller inventories. Smaller inventories required the frequent and reliable supply of merchandise in accurate, small quantities, which was a requirement that wholesalers had learned to efficiently fulfill upon the emergence of convenience stores.
- **Order function and access to manufacturers:** Retailers tried to differentiate

themselves by offering a broad product assortment and regularly introducing new products. Ordering through wholesalers allowed them access to a large number of manufacturers, and it kept the number of suppliers that they dealt with, and thereby their costs, at a comparatively low level.

Retailers also depended on their suppliers **for consignment selling, supplier-employed sales staff** (who would reduce their personnel costs), and **merchandising know-how**. These practices, which had developed after World War II, led to a distinct distribution of functions between retailers and wholesalers in Japan wherein even large retailers continually included wholesalers in their sourcing arrangement.

With these findings in mind, we suggest that the optimistic evaluations were based on a number of misconceptions regarding the Japanese distribution system.

- Legislation was not the main factor shaping the structure of the Japanese retail market and its large number of small traditional retailers. The decline in the number of small retailers, which manifested itself in the form of a decline in traditional food shops, started after grocery supermarkets had established a countrywide competitive advantage by adopting a new technology (selling pre-packaged perishable foods in open refrigerators). The spread of the pre-packaging system, along with a favorable consumer environment, also triggered the growth of convenience stores, which catered better to consumers' needs than did small traditional retailers.
- The conventional explanation for the multi-layered wholesale sector, namely the large number of small retailers, needs to be questioned. As our analysis has shown, the multi-layered wholesale sector remained in place despite the expansion of supermarkets from the 1960s onwards. Supermarkets, despite their size and against all predictions, sourced through secondary wholesalers because they provided them with the necessary resources for their expansion and efficient access to a large number of manufacturers. Secondary wholesalers also provided supermarkets with access to local products and an understanding of local tastes. Hence, supermarkets lacked *resources* and *power* to alter their sourcing routes. As we have shown further, the intermediate wholesalers (the type expected to decline most with the increase in the number of large stores) actually increased in number between 1994 and 2002, despite a continuous decrease in the number of small retailers. This

increase was caused by manufacturers' and wholesalers' searching for greater efficiency and new business opportunities.

- Retailer size and direct sourcing are not necessarily correlated as is generally assumed. We suggest that even though the number of large retailers increased, direct sourcing remained a limited phenomenon in Japan. We believe that large retailers (*size*) continued to include wholesalers in their sourcing arrangement (i.e., *wholesale circuitry* \neq 0) during the timeframe studied for the following reason. Given their strategy of maximizing sales floor space, minimizing inventory and competing on product selection, and because of their loan burden, retailers did not have the necessary *resources* (in terms of financial resources and know-how) to internalize wholesaler functions such as merchandising or dispatching sales personnel. In addition, they did not have the necessary *power* to shift wholesaler functions to manufacturers because they depended on manufacturers for their constant flow of new products and consignment selling. Hence, the prerequisites for direct sourcing arrangements, *retailer resources* and *power*, were not fulfilled. The question of direct sourcing, however, requires further research; no reliable quantitative data seem to be available.

These findings underline the importance of this study to our understanding of the Japanese distribution system. The study sheds new light on the impact of legislation on the formation of the Japanese distribution system and highlights the importance of taking into account country-specific and historical factors as well as considering the distribution of resources among channel participants when analyzing distribution systems. Last but not least, it contributes to the body of research on direct sourcing in Japan and offers an economic explanation for the perceived low level of direct relationship between retailers and manufacturers in Japan.

6.2 Further research

This study concludes by highlighting two areas for further research.

- Future studies should aim to quantitatively verify the arguments put forward here with regard to direct sourcing, specifically addressing the claim that direct sourcing did not substantially increase after the revision of the Large-Scale Retail Stores Law

because of the following considerations:

- Wholesalers are highly efficient in ordering, storing, and delivering goods, thereby allowing retailers to focus on how to most comprehensively utilize their sales space.
- Retailers depend on their suppliers for their merchandising expertise, goods and additional employees.
- Furthermore, because there exists a certain degree of direct sourcing, using empirical data to answer the following questions will increase our understanding of direct sourcing in Japan:
 - What share of products is sourced directly? Since when and why? Has this share changed over time?
 - What kinds of products are sourced directly? Since when and why? Have these types of product changed over time?
 - What are the characteristics of retailers that source goods directly?
 - What are the characteristics of manufacturers that supply directly vs. manufacturers that supply via wholesalers only?

The results will also be highly relevant for foreign retailers entering Japan with the aim of seeking direct-supply arrangements with Japanese manufacturers, helping them to understand what blocks retailers from buying directly from suppliers.

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EDUCATION

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1996	Kyoto University of Foreign Studies, Japan: Intensive Japanese language course (Japanese Language Proficiency Level 1)
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